





PC CONNECTION, INC. AND SUBSIDIARIES

FORM 10-K ANNUAL REPORT  
YEAR ENDED DECEMBER 31, 2000

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## PART I

### ITEM 1. Business

This section contains forward-looking statements based on management's current expectations, estimates and projections about the industry in which we operate, management's beliefs and certain assumptions made by management. All statements, trends, analyses and other information contained in this report relative to trends in net sales, gross margin and anticipated expense levels, as well as other statements, including words such as "anticipate", "believe", "plan", "estimate" and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption "Factors That May Affect Future Results and Financial Condition" included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations". Particular attention should be paid to the cautionary statements involving the industry's rapid technological change and exposure to inventory obsolescence, availability and allocations of goods, reliance on vendor support and relationships, competitive risks, pricing risks and economic risks. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.

#### General

PC Connection, Inc. and subsidiaries (together, referred to below as "PC Connection", or "the Company") is a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, accessories and networking products. The Company markets its products principally to small and medium-sized businesses, which are referred to as SMBs, comprised of 20 to 1,000 employees. The Company also markets its products to larger businesses, governmental and educational organizations and consumers. The Company sells its products through a combination of targeted direct mail catalogs, outbound telemarketing, its Internet web site and advertisements on the Internet and in selected computer magazines. The Company offers a broad selection of approximately 100,000 products targeted for business use at competitive prices, including products from Compaq, Hewlett-Packard, Toshiba, IBM, Microsoft, Sony, EMC, Canon, Iomega and Apple. Net sales of Microsoft Windows or MS-DOS based personal computers, or PCs, and compatible products were approximately 90% of net sales in 2000. The Company's most frequently ordered products are carried in inventory and are typically shipped to customers the same day that the order is received.

Since its founding in 1982, PC Connection has served its customers' needs by providing innovative, reliable and timely service and technical support, and by offering more than 100,000 brand-name products through its technically-trained sales and support teams. The effectiveness of this strategy is reflected by the recognition the Company continues to receive. For the year 2000, PC Connection was ranked number 7 in Business Week's annual listing of the world's leading information technology companies, and was listed on the Forbes Platinum 400 List for the first time. Yahoo! Internet Life recently named PC Connection, "the best place to shop for computers," and listed the Company's web sites; pconnection.com and macconnection.com, among the 100 Best Sites on the Internet. PC Connection was listed as one of the 100 most influential companies in the computer industry in PC Magazine's special issue titled, "100 Technology Companies That Are Changing the World." In addition, PC Connection has won PC World magazine's prestigious "World Class Award" nine times over the past eleven years, including 2000.

The Company believes that its consistent customer focus has also resulted in the development of strong brand name recognition and a broad and loyal customer base. At December 31, 2000, the Company's mailing list consisted of approximately 3,117,000 customers and potential customers, of which approximately 626,000 had purchased products from the Company within the last twelve months. Approximately 79% of its net sales in the year ended December 31, 2000 were made to customers who had previously purchased products from the

Company. Management believes that the Company also has strong relationships with vendors, resulting in favorable product allocations and marketing assistance.

The Company's fastest growing customer segments include businesses which are investing aggressively in web-based marketing programs and other high growth organizations which are increasingly dependent on distributed data and communication networks. Management believes that the Company's pioneering Everything Overnight(R) program has set it apart as the premier rapid response supplier of information technology products and solutions to the middle market.

Enterprise networking infrastructure products, such as PC-based servers, routers and switches, were among the Company's fastest growing product categories in 2000, increasing by more than 102% in 2000 compared to 1999. Sales of enterprise networking products accounted for 17.4% of total net sales in 2000, up from 11.6% of total net sales in 1999. Over the next few years, the Company anticipates that an increasing share of its revenues will come from the sale of enterprise networking infrastructure products and services, including network-based storage solutions, versus the current sales concentration in desktop and portable computers.

During 2000, the Company invested heavily in training, technical certification and other programs to support the rapidly growing demand from its customers for networking and related products. The Company launched its proprietary Network Solutions Consultant program in January 2000.

The Company focuses its business-to-business marketing efforts primarily on SMBs, a rapidly growing sector of the market that the Company believes is particularly receptive to purchases from direct marketers. In order to service this growing part of its business more effectively, the Company increased the number of its outbound telemarketing account managers from 345 at December 31, 1999 to 575 at December 31, 2000. This growth includes 327 new account managers with fewer than 12 months of outbound telemarketing experience with the Company.

The Company's two major catalogs are PC Connection(R), focused on PCs and compatible products, and MacConnection(R), focused on Apple Macintosh personal computers, known as "Macs", and compatible products. With colorful illustrations, concise product descriptions, relevant technical information and toll-free telephone numbers for ordering, the Company's catalogs are recognized as a leading source for personal computer hardware, software and other related products. The Company distributed approximately 45 million catalogs during the year ended December 31, 2000.

The Company also markets its products and services through its Internet web sites, [www.pcconnection.com](http://www.pcconnection.com) and [www.macconnection.com](http://www.macconnection.com). The Company's web sites provide customers and prospective customers with product information and enable customers to place electronic orders for products. Internet sales processed directly online during the fourth quarter of 2000 were \$30.6 million, or 8.9% of that quarter's net sales. Online sales in the fourth quarter of 2000 increased 55.3% over the comparable quarter in 1999. For the fiscal year 2000, these sales were \$113.0 million, or 7.8% of net sales, compared to 5.6% in 1999. These results represent a 86.5% increase in annual Internet sales over 1999.

The Company believes that the reason its electronic commerce business is growing so rapidly is that it offers customers the advanced tools they need to quickly make educated purchasing decisions. Working closely with vendors, the Company believes that it is able to provide one of the broadest, leading-edge technology selections in the industry. By using its merchandising expertise, catalog mailings and established infrastructure, the Company has built a profitable Internet business and one that complements all its other sales channels.

For the Company the web fundamentally supports three key business initiatives:

- . Providing customer choice--The Company has built its business on the premise that its customers should be able to choose how they interact with the Company, be it by mail, telephone, fax, e-mail or over the web.
- . Lowering transactions costs--The Company's web site tools, including robust product search features, Smart Selectors(R), Internet Business Accounts(R) and special interest pages, allow customers to

quickly and easily find information about products of interest to them. If they still have questions, the Company's Telesales Representatives and Outbound Account Managers are just a phone call away. Such phone calls are typically shorter and have higher close rates than calls from customers who have not first visited our web sites.

- . Leveraging the time of experienced Account Managers--The Company's investments in technology-based sales and service programs demonstrate the power of technology at its best, leveraging its Account Managers to do what they do best: building and maintaining relationships with customers and helping them to solve their business problems.

#### Formation of Holding Company

On January 1, 2000, the Company formed a new holding company structure to support PC Connection's future growth and plans to expand its current business lines through internal growth and potential acquisitions.

Outstanding shares of common stock representing interests in PC Connection prior to the holding company formation were converted into shares of the new holding company on a one-for-one basis through a non-taxable transaction. Common stock shares of the new holding company trade on the Nasdaq National Market under the symbol, "PCCC", the same exchange and symbol used by the predecessor company. The new shares hold the same voting power that shares of the predecessor held. No additional capital stock was issued as part of the transaction. The directors and officers of the predecessor company serve as the directors and officers of the new holding company.

#### Industry Background

The SMB marketplace is very large including approximately 7.4 million small businesses with fewer than 100 employees and approximately 157,000 medium businesses with 100 to 999 employees. SMB's annually spend approximately \$150 billion on information technology (IT) products and services with approximately \$103 billion spent in product categories addressed by the Company's product and services offerings. These estimates exclude IT spending by consumers, home-based businesses and educational, not-for-profit and governmental organizations.

The Company believes that sales of personal computers and related products have increased principally as a result of:

- . technological advances leading to significant improvements in performance, functionality and ease of use;
- . lower prices and improved price/performance driven by intense competition among manufacturers, retailers and resellers;
- . increased dependence upon PCs by businesses, educational institutions and governments;
- . the emergence of industry standards and component commonality;
- . upgrade of electronic commerce capabilities.

The Company believes that the direct marketing channel will continue to grow faster than the overall industry due primarily to increased user familiarity with PCs, coupled with the emergence of industry standards and component commonality, broader product offerings, lower prices and greater purchasing convenience that direct marketers generally provide over traditional retail stores and local dealers.

Users of personal computers range from large corporate entities focused on business applications to individual consumers focused primarily on personal productivity, education and entertainment applications.

Historically, large corporate resellers have served the needs of FORTUNE 1000 companies, and retailers have competed to serve the consumer market. SMBs, the Company's core target customers, are being served by a wide range of suppliers, including direct marketers, large retailers, small, independent, value-added resellers ("VARs"), and local dealerships. The Company believes that the direct field sales model used by large resellers is not an efficient method of reaching SMBs, and that VARs, local dealerships and retailers are unable to match the high level of customer service, extensive selection of products and low prices afforded to SMBs by direct marketers. Intense competition for market share has led manufacturers of PCs and related products to use all available channels to distribute products, including direct marketers. Although certain manufacturers that have traditionally used resellers to distribute their products have established or attempted to establish their own direct marketing operations, including sales through the Internet, the Company believes these manufacturers will continue to provide the Company and other third-party direct marketers favorable product allocations and marketing support.

The Company believes new entrants to the direct marketing channel must overcome a number of obstacles, including:

- . the time and resources required to build a meaningful customer base, quality and responsiveness for cost-effective circulation;
- . costs of developing the information and operating infrastructure required by direct marketers;
- . the advantages enjoyed by larger and more established competitors in terms of purchasing and operating efficiencies;
- . the difficulty of building relationships with manufacturers to achieve favorable product allocations and attractive pricing terms; and
- . the difficulty of identifying and recruiting management personnel with significant direct marketing experience in the industry.

#### Business Strategies

The Company's objective is to become the leading rapid response supplier of information technology products and solutions, including personal computers and related products and services, to the Company's customers. The key elements of the Company's business strategies include:

- . The Company provides award-winning customer service before, during and after the sale. The Company believes that it has earned a reputation for providing superior customer service by consistently focusing on its customer needs. The Company has won PC World's "World Class Award for Best Mail Order Company" in nine out of the last eleven years, including a 2000 award for "Best Online/Mail Order Catalog Company". The Company delivers value to its customers through high quality service and technical support provided by its knowledgeable, well-trained personnel. The Company has efficient and innovative delivery programs. It also offers its customers competitive prices and reasonable return policies.
- . The Company maintains a strong brand name and customer awareness. Since its founding in 1982, the Company has built a strong brand name and customer awareness. In July 1999, the Company was the only direct reseller included in the "100 Most Influential Companies in the Computer Industry" by PC Magazine. In 1998 and 1997, the Company was one of only two direct resellers included in the listing. The Company's mailing list includes approximately 3,117,000 names, of which approximately 626,000 have purchased products from the Company during the last 12 months. In 1999, PC Connection ranked among the "Top 100 Hottest Companies on the Internet" by Business 2.0 Magazine.
- . The Company offers a broad product selection at competitive prices. The Company offers its customers a wide assortment of computing, networking, data storage and related products at

competitive prices. The Company's merchandising programs feature products that provide customers with aggressive price and performance and the convenience of one-stop shopping for their personal computer and related needs.

- . The Company has long-standing vendor relationships. The Company has a history of strong relationships with vendors, and it was among the first direct marketers qualified by manufacturers to market systems to end-users. The Company provides its vendors with both information concerning customer preferences and an efficient channel for the advertising and distribution of their products.

#### Growth Strategies

The Company's growth strategies are to expand and increase penetration of its existing customer base and to broaden its product offerings. The key elements of the Company's growth strategies include the following:

- . Increase outbound telemarketing. The Company plans to continue to increase the number of corporate outbound account managers and assign them to a greater number of customers. Outbound account managers focus exclusively on serving specifically assigned customers and seek to develop a close relationship with those customers by identifying and responding to their needs for computing, networking, data storage and related products.
- . Expand product offerings. The Company continually evaluates information technology products focused on business users, adding new products as they become available or in response to customer demand. The Company works closely with vendors to identify and source first-to-market product offerings at aggressive prices and believes that the expansion of its corporate outbound marketing program will enhance its access to such product offerings. During 2000 and early 2001, PC Connection became the first direct marketer authorized by EMC Corporation to sell EMC's CLARiiON line of mid-range storage area network (SAN) and network attached storage (NAS) data storage products. EMC is currently the world leader in the sale of networked storage solutions.
- . Target specific customer populations. Through targeted mailings, the Company seeks to expand the number of active customers and generate additional sales from its existing customers. The Company has developed specialty catalogs, as well as standard catalogs with special cover pages, featuring product offerings designed to address the needs of specific customer populations, including new product inserts targeted to purchasers of graphics, server and networking products.
- . Expand electronic commerce channel. The Company's Internet web-based catalog provides detailed product descriptions, product search capabilities and on-line order processing. The Company has seen a rapid increase in on-line sales and believes that an increasing number of customers and potential new customers will shop electronically in the future. Therefore, the Company plans to further improve on-line sales capabilities, customer service and product information and customer support available on its Internet web site. During 2000, the number of customers utilizing the Company's proprietary Internet Business Accounts(R) grew six-fold to over 15,500 at December 31, 2000.
- . Pursue strategic acquisitions and alliances. The Company completed its first acquisition in June 1999 of ComTeq Federal, Inc. ("ComTeq"). ComTeq, based in Rockville, Maryland, is a specialty reseller focused on agencies of the federal government. The Company acquired the Merisel Americas, Inc. call center in Marlborough, Massachusetts in January 2000. Through its acquisition program, the Company seeks to acquire new customers, strengthen its product offerings, add management talent and produce operating results, which are accretive to its core business earnings.

#### Service and Support

Since the Company's founding in 1982, its primary objective has been to provide products that meet the demands and needs of customers and to supplement those products with up-to-date product information and excellent customer service and support. The Company believes that offering its customers superior value,



through a combination of product knowledge, consistent and reliable service and leading products at competitive prices, differentiates it from other direct marketers and establishes the foundation for developing a broad and loyal customer base. The Company has introduced programs such as Toll-Free Technical Support in 1982, the Everything Overnight(R) delivery program in 1988, Money Back Guarantees in 1989, One-Minute Mail Order(R) in 1991, On-line Superstore in 1997, and Your Brands, Your Way, Next Day(R) in 1998.

The Company invests in training programs for its service and support personnel, with an emphasis on putting customer needs and service first. Customer service representatives are available 24 hours a day, seven days a week to handle orders, product information, general inquiries and technical support questions.

The Company provides toll-free technical support from 9 a.m. through 5 p.m., Eastern Standard Time, Monday through Friday. Product support technicians assist callers with questions concerning compatibility, installation, determination of defects and more difficult questions relating to product use. The product support technicians authorize customers to return defective or incompatible products to either the manufacturer or to the Company for warranty service. In-house technicians perform both warranty and non-warranty repair on most major systems and hardware products.

Using its customized information system, the Company sends its customer orders to its distribution center for processing immediately after a customer receives credit approval. Through its Everything Overnight(R) service, it guarantees that all orders for in-stock merchandise accepted up until 2:00 a.m. (until midnight on most custom-configured systems) can be shipped for overnight delivery via Airborne Express. The Company also configures approximately 20% of the computer systems it sells. Configuration typically consists of the installation of memory, accessories and/or software.

#### Marketing And Sales

The Company sells products through its direct marketing channel, primarily to SMBs. The Company seeks to be the primary supplier of computing, networking, data storage and related products to its existing customers and to expand its customer base. The Company uses multiple marketing approaches to reach existing and prospective customers, including:

- . outbound telemarketing;
- . catalogs and inbound telesales;
- . Web and print media advertising; and
- . marketing programs targeted to specific customer populations.

All of its marketing approaches emphasize its broad product offerings, fast delivery, customer support, competitive pricing and multiple payment options.

The Company believes that its ability to establish and maintain long-term customer relationships and to encourage repeat purchases is largely dependent on the strength of its telemarketing personnel and programs. Because customers' primary contact with the Company is through its telemarketers, the Company is committed to maintaining a qualified, knowledgeable and motivated sales staff with its principal focus on customer service.

The following table sets forth the Company's percentage of net sales by sales channel:

	Years Ended December 31,		
	2000	1999	1998
Sales Channel			
Corporate Outbound.....	76%	65%	53%
Inbound Telesales.....	16	29	43
On-Line Internet.....	8	6	4
	---	---	---
Total.....	100%	100%	100%
	===	===	===

Outbound Telemarketing. The Company seeks to build loyal relationships with its potential high-volume customers by assigning them to individual account managers. The Company believes that customers respond favorably to a one-on-one relationship with personalized, well-trained account managers. Once established, these one-on-one relationships are maintained and enhanced through frequent telecommunications, targeted catalogs and other marketing materials designed to meet each customer's specific computing needs.

Account managers focus exclusively on their managed accounts and on outbound sales calls to prospective customers. The Company generally recruits account managers from other sales organizations and from its inbound telemarketing staff. All account managers must successfully complete a two-month training program, which includes instruction in the Company's product offerings and order management systems, as well as selling skills and account management. Thereafter, new account managers are assigned to sales teams where they receive intensive coaching and supervision by experienced supervisors, and periodic refresher training from the sales training staff. Additional training and product education programs are provided continuously through programs supported by the Company's vendors. The Company pays its account managers a base annual salary plus incentive compensation. Incentive compensation is tied to sales volume and gross profit dollar goals by the individual account manager. Account managers historically have significantly increased productivity after approximately 12 months of training and experience. At December 31, 2000, the Company employed 575 account managers, including 327 with fewer than 12 months of outbound telemarketing experience with the Company.

Catalogs and Inbound Telesales. The Company's two principal catalogs are PC Connection(R) for the PC market and MacConnection(R) for the Mac market. The Company publishes twelve editions of each of these catalogs annually. The Company distributes catalogs to purchasers on its in-house mailing list as well as to other prospective customers. The Company sends its two principal catalogs to its best customers twice each month. The initial mailing each month, labeled an "early edition," is sent simultaneously to the best customers throughout the United States and features special offers, such as first-to-market product offerings, highlighted on the cover. The Company also includes a catalog with each order shipped.

In addition, the Company mails specialty catalogs or customized versions of its catalogs to selected customers. The Company distributes specialty catalogs to educational and governmental customers and prospects on a periodic basis. The Company also distributes its monthly catalogs customized with special covers and inserts, offering a wider assortment of special offers on products in specific areas, such as graphics, server/netcom and mobile computing, or for specific customers, such as developers. These customized catalogs are distributed to targeted customers included in the Company's customer database using past identification or purchase history, as well as to outside mailing lists.

Each catalog is printed with full-color photographs, detailed product descriptions and manufacturer specifications. The catalogs are primarily created by in-house designers and production artists on a computer-based desktop publishing system. The in-house preparation of most portions of the catalog expedites the Company's production process and provides it with greater flexibility and creativity in catalog production by allowing for last-minute changes in pricing and format. Overall, such in-house preparation results in significant

cost savings to the Company. After completion of the design and preparation, the Company outsources the catalogs to commercial printers for printing.

The Company's inbound sales representatives answer customer telephone calls generated by its catalog, magazine and other advertising programs. These representatives also assist customers in making purchasing decisions, process product orders and respond to customer inquiries on order status, product pricing and availability. The Company provides training to its inbound telemarketing personnel and provides incentive compensation based upon sales productivity. The Company has a flexible staffing model which allows it to maintain excellent customer service during periods of peak demand while maintaining an efficient cost structure. The Company regularly monitors calls for quality assurance purposes and has been a pioneer in using caller identification for the instant retrieval of customer records. Using proprietary information systems, sales representatives can quickly access customer records which detail purchase history and billing and shipping information, expediting the ordering process. In addition to receiving orders through its toll-free numbers, orders are also received via fax, mail and electronic mail.

Advertising. The Company has historically advertised in selected personal computer and trade magazines, such as PC Magazine, PC World and Macworld. These advertisements provide potential customers with product descriptions, manufacturers' specifications and pricing information, while emphasizing the Company's service and support features. Additionally, the PC Connection(R) logo and telephone numbers are included in promotions by selected manufacturers.

www.pcconnection.com. In November 1996, the Company launched an Internet web site, which includes a complete product catalog. In July 1997, the Company began accepting electronic orders through its Internet web site. The Company also provides updated information for over 23,000 items and on screen images available for over 6,000 items. The Company offers, and continuously updates, selected product offerings and other special buys. The Company believes that in the future its Internet web site will be an important sales source and communication tool for improving customer service.

Specialty Marketing. The Company's specialty marketing activities include direct mail, other inbound and outbound telemarketing services, bulletin board services, "fax on demand" services, package inserts, fax broadcasts and electronic mail. The Company also markets call-answering and fulfillment services to certain of its product vendors.

Customers. The Company currently maintains an extensive database of customers and prospects aggregating approximately 3,117,000 names. During the year ended December 31, 2000, the Company received orders from approximately 626,000 customers. Approximately 79% of its net sales in the year ended December 31, 2000 were made to customers who had previously purchased products from the Company, representing an 11% increase from the prior year.

#### Products And Merchandising

The Company continuously focuses on expanding the breadth of its product offerings. The Company currently offers approximately 100,000 computing, networking, data storage and related products designed for business applications from over 1,000 manufacturers. The Company offers both PCs and Macs and related products. In 2000, sales of PCs and related products were approximately 90% of net sales. The Company selects the products that it sells based upon their technology and effectiveness, market demand, product features, quality, price, margins and warranties. As part of its merchandising strategy, the Company also offers new types of products related to PCs, such as digital cameras.

The following table sets forth the Company's percentage of net sales (in dollars) of notebook computers, desktop and server computers, storage devices, software, networking communications, printers, video and monitors, memory, accessories and other products during the years ended December 31, 2000, 1999 and 1998.

	Percentage Of Net Sales		
	Years Ended December 31,		
	2000	1999	1998
Notebooks.....	25%	23%	20%
Desktops/Servers.....	15	15	15
Storage Devices.....	10	10	11
Software.....	10	12	14
Networking Communications.....	8	6	6
Printers.....	7	9	8
Video & Monitors.....	8	8	8
Memory.....	4	4	4
Accessories/Other.....	13	13	14
	---	---	---
TOTAL.....	100%	100%	100%
	===	===	===

The Company offers a limited 30-day money back guarantee for most unopened products and selected opened products, although selected products are subject to restocking fees. Substantially all of the products marketed by the Company are warranted by the manufacturer. The Company generally accepts returns directly from the customer and then either credits the customer's account or ships the customer a similar product from its inventory.

#### Purchasing And Vendor Relations

For the year ended December 31, 2000, the Company purchased approximately 43% of its products directly from manufacturers and the balance from distributors and aggregators. The majority of products are shipped directly to the Company's distribution facility in Wilmington, Ohio. During the years ended December 31, 2000 and 1999, product purchases from Ingram Micro, Inc., the Company's largest vendor, accounted for approximately 25.6% and 21.7%, respectively, of its total product purchases. Purchases from Tech Data Corporation comprised 11.2% and 7.0% of the Company's total purchases in the years ended December 31, 2000 and 1999, respectively. No other vendor accounted for more than 10% of the Company's total product purchases. The Company believes that alternative sources for products obtained from Ingram Micro, Inc. and Tech Data Corporation are available.

Many product suppliers reimburse the Company for advertisements or other cooperative marketing programs in the Company's catalogs or advertisements in personal computer magazines that feature a manufacturer's product. Reimbursements may be in the form of discounts, advertising allowances and/or rebates. The Company also receives reimbursements from certain vendors based upon the volume of purchases or sales of the vendors' products. Historically, the Company received price consideration and support including price protection and rebates from its vendors on a majority of the products it sold.

Price protection takes the form of rebates or credits against future purchases. The Company may participate in end-of-life-cycle and other special purchases which may not be eligible for price protection.

The Company believes that it has excellent relationships with vendors. The Company generally pays vendors within stated terms and takes advantage of all appropriate discounts. The Company believes that because of its volume purchases it is able to obtain product pricing and terms that are competitive with those available to other major direct marketers. Although brand names and individual product offerings are important to its business, the Company believes that competitive sources of supply are available in substantially all of the merchandise categories offered.

## Distribution

At the Company's approximately 205,000 square foot distribution and fulfillment complex in Wilmington, Ohio, the Company receives and ships inventory, configures computer systems and processes returned products. Orders are transmitted electronically from the Company's New Hampshire and Massachusetts sales facilities to the Wilmington distribution center after credit approval, where packing documentation is printed automatically and order fulfillment takes place. Through its Everything Overnight service, the Company guarantees that all orders for in-stock merchandise accepted up until 2:00 a.m. Eastern Standard Time (until midnight on custom-configured systems) can be shipped for overnight delivery via Airborne Express. The Company ships approximately 62% of its orders through Airborne Express. Upon request, orders may also be shipped by other common carriers.

The Maryland sales facility of ComTeq Federal primarily places product orders directly with manufacturers and/or distribution companies for drop shipment by those manufacturers and/or suppliers directly to ComTeq's customers. Order status with distributors is tracked on line and in all circumstances, a confirmation of shipment from manufacturers and/or distribution companies is received prior to recording revenue.

## Management Information Systems

The Company uses management information systems, principally comprised of applications software running on IBM AS/400 and RS6000 computers and Microsoft NT-based servers, which the Company has customized for its use. These systems permit centralized management of key functions, including order taking and processing, inventory and accounts receivable management, purchasing, sales and distribution, and the preparation of daily operating control reports on key aspects of the business. The Company also operates advanced telecommunications equipment to support its sales and customer service operations. Key elements of the Company's telecommunications systems are integrated with the Company's computer systems to provide timely customer information to sales and service representatives, and to facilitate the preparation of operating and performance data. The Company believes that its customized information systems enable it to improve productivity, ship customer orders on a same-day basis, respond quickly to changes in the Company's industry and provide high levels of customer service.

The Company's success is dependent in large part on the accuracy and proper use of its information systems, including its telephone systems, to manage its inventory and accounts receivable collections, to purchase, sell and ship the Company's products efficiently and on a timely basis, and to maintain cost-efficient operations. The Company expects to continually upgrade its information systems to more effectively manage its operations and customer database. In 1998, the Company replaced its order management and fulfillment software with new software and converted its principal computer equipment to new IBM AS400 platform systems, both of which are better suited to its expected scale of operations and were designed to be Year 2000 compliant.

## Competition

The direct marketing and sale of computing, networking, data storage and related products is highly competitive. PC Connection competes with other direct marketers of computers and related products, including CDW Computer Centers, Inc. and Insight Enterprises, Inc. The Company also competes with:

- . certain product manufacturers that sell directly to customers, such as Dell Computer Corporation and Gateway, Inc. and, more recently, Compaq, IBM and Apple;
- . distributors that sell directly to certain customers, such as MicroAge, Inc.;
- . various cost-plus aggregators, franchisers and national computer retailers, such as CompUSA, Inc.; and
- . companies with more extensive Internet web sites and commercial on-line networks.

Additional competition may arise if other new methods of distribution, such as broadband electronic software distribution, emerge in the future.

The Company competes not only for customers, but also for favorable product allocations and cooperative advertising support from product manufacturers. Several of the Company's competitors are larger and have substantially greater financial resources.

The Company believes that price, product selection and availability, and service and support are the most important competitive factors in its industry.

#### Intellectual Property Rights

The Company's trademarks include PC Connection(R) and MacConnection(R) and their related logos; Everything Overnight(R), One-Minute Mail Order(R), PC & Mac Connection(R), Systems Connection(R), The Connection(R), Raccoon Character(R), Service Connection(TM), Graphics Connection(TM), Memory Connection(TM), Your Brands, Your Way, Next Day(R), Epiq PC Systems(R) and Webase(R). The Company intends to use and protect these and its other marks, as it deems necessary. The Company believes its trademarks and service marks have significant value and are an important factor in the marketing of its products. The Company does not maintain a traditional research and development group, but it works closely with computer product manufacturers and other technology developers to stay abreast of the latest developments in computing technology, both with respect to the products it sells and uses.

#### Employees

As of December 31, 2000, the Company employed 1,654 persons, of whom 806 were engaged in sales related activities, 99 were engaged in providing customer service and support, 423 were engaged in purchasing, marketing and distribution related activities, 116 were engaged in the operation and development of management information systems, and 210 were engaged in administrative and accounting functions. The Company considers its employee relations to be good. The Company's employees are not represented by a labor union and the Company has never experienced a work stoppage since its inception.

#### ITEM 2. Properties

In November 1997, the Company entered into a fifteen year lease for a new corporate headquarters and telemarketing center located at Route 101A, 730 Milford Road, Merrimack, New Hampshire 03054-4631, with an affiliated entity, related to the Company through common ownership. The Company occupied this facility upon completion of construction in late November 1998 and the lease payments commenced in December 1998. The Company also leases 205,000 square feet in two facilities in Wilmington, Ohio, which houses its distribution and order fulfillment operations. The Company also operates telemarketing centers in Dover, Amherst and Keene, New Hampshire, as well as Marlborough, Massachusetts and Rockville, Maryland. While the Company believes that its existing distribution facilities in Wilmington, Ohio will be sufficient to support the Company's anticipated needs through the next twelve months, it is evaluating additional and/or alternative facilities for distribution to support future growth.

#### ITEM 3. Legal Proceedings

The Company currently is not a party to any material legal proceedings, other than ordinary routine litigation incidental to the business.

#### ITEM 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted during the fourth quarter of 2000 to a vote of security holders.

## Executive Officers

The executive officers of the Company and their ages as of March 27, 2001 are as follows:

Name	Age	Position
----	---	-----
Patricia Gallup	47	Chairman of the Board and Chief Executive Officer
David Hall	51	Vice Chairman of the Board
Wayne L. Wilson	52	President and Chief Operating Officer
Robert F. Wilkins	39	Executive Vice President
Mark A. Gavin	39	Senior Vice President of Finance and Chief Financial Officer
John L. Bomba, Jr.	47	Vice President of Information Services and Chief Information Officer
Bradley G. Mousseau	49	Vice President of Human Resources

Patricia Gallup is a co-founder of the Company and has served as Chairman of the Board and Chief Executive Officer of the Company since January 1998. From September 1995 to January 1998, Ms. Gallup served as the Chairman of the Board, President and Chief Executive Officer of the Company. From September 1994 to September 1995, she served as Chairman of the Board and Chief Executive Officer of the Company. From August 1990 to September 1994, Ms. Gallup served as the Company's President and Chief Executive Officer.

David Hall is a co-founder of the Company and has served as Vice Chairman of the Board since November 1997. From June 1997 to November 1997, Mr. Hall served as the Vice Chairman of the Board, Executive Vice President and Treasurer of the Company. From February 1995 to June 1997, Mr. Hall served as the Company's Vice Chairman of the Board and Executive Vice President. From March 1991 to February 1995, he served as the Executive Vice President of the Company.

Wayne L. Wilson has served as President and Chief Operating Officer of the Company since January 1998 and Chief Financial Officer from January 1998 to March 1998. From January 1996 to January 1998, Mr. Wilson served as Senior Vice President, Chief Operating Officer and Chief Financial Officer of the Company. From August 1995 to January 1996, he served as Senior Vice President of Finance and Chief Financial Officer of the Company. Prior to joining the Company, Mr. Wilson was a partner in the accounting and consulting firm of Deloitte & Touche LLP from June 1986 to August 1995.

Robert F. Wilkins has served as Executive Vice President of the Company since January 2000. Mr. Wilkins served as Senior Vice President of Sales and Marketing from January 1999 to January 2000 and Senior Vice President of Merchandising and Product Management of the Company from January 1998 to January 1999. From December 1995 to January 1998, Mr. Wilkins served as Vice President of Merchandising and Product Management of the Company. From September 1994 to December 1995 he was a consultant to the Company and certain of its affiliates. From February 1990 to September 1994, Mr. Wilkins served as President of Mac's Place.

Mark A. Gavin has served as Senior Vice President of Finance and Chief Financial Officer since January 2000 and as Vice President of Finance and Chief Financial Officer of the Company since March 1998. Prior to joining PC Connection, Mr. Gavin held the position of Executive Vice President and Chief Operating Officer at CFX Corporation, a bank holding company in Keene, New Hampshire. Prior to CFX, Mr. Gavin worked as a Manager for Ernst & Young, LLP.

John L. Bomba, Jr. has served as Vice President of Information Services and Chief Information Officer of the Company since May 1997. From May 1994 to April 1997, Mr. Bomba served as Director of Worldwide Information Systems for Micro Warehouse, Inc. Prior to May 1994 he served as Director of Professional Services for Innovative Information Systems, Inc.

Bradley G. Mousseau has served as Vice President of Human Resources since January 2000. Prior to joining PC Connection, Mr. Mousseau served as Vice President of Global Workforce Strategies for Systems & Computer Technology Corporation (SCT) from April 1997 to January 2000. Prior to SCT, Mr. Mousseau served as Vice President of Human Resources for Gabreili Medical Info Systems.

PART II

ITEM 5. Market for the Registrant's Common Stock and Related Stockholder Matters

Market Information

The Company's Common Stock commenced trading on March 3, 1998 on the Nasdaq National Market under the symbol "PCCC". As of March 22, 2001, there were 24,418,860 shares outstanding of the Common Stock of the Company held by approximately 80 stockholders of record.

The following table sets forth for the fiscal periods indicated the range of high and low bid prices for the Company's Common Stock on the Nasdaq National Market. These prices reflect the three-for-two stock split distributed on May 23, 2000.

2000	High	Low
- - - - -	- - - - -	- - - - -
Quarter Ended:		
December 31.....	\$56.38	\$ 8.63
September 30.....	70.25	42.44
June 30.....	58.50	17.67
March 31.....	23.33	14.17

1999		
- - - - -		
Quarter Ended:		
December 31.....	\$23.25	\$ 9.11
September 30.....	11.58	8.00
June 30.....	12.67	8.00
March 31.....	18.08	7.42

The Company has never declared or paid cash dividends on its capital stock. The Company currently anticipates that it will retain all future earnings, if any, to fund the development and growth of its business and does not anticipate paying any cash dividends on its Common Stock in the foreseeable future.

ITEM 6. Selected Financial and Operating Data

The following selected financial and operating data should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere herein. The selected data presented below under the captions "Statement of Operations Data" and "Balance Sheet Data" for each of the years in the five-year period ended December 31, 2000 are derived from the audited financial statements of the Company. The Company's consolidated financial statements as of December 31, 2000 and 1999 and for each of the years in the three-year period ended December 31, 2000 and the independent auditors' report thereon, are included elsewhere herein.



Years Ended December 31,

	2000	1999	1998	1997	1996
--	------	------	------	------	------

(dollars in thousands, except per share and selected operating data)

Statement of Operations

Data:					
Net sales(1).....	\$1,449,908	\$1,080,835	\$ 749,905	\$ 562,511	\$ 340,811
Cost of sales(1).....	1,273,687	951,489	656,631	486,545	289,606
Gross profit.....	176,221	129,346	93,274	75,966	51,205
Selling, general and administrative expenses.....	123,972	91,405	68,521	56,596	43,739
Additional stockholder/officer compensation(2) .....	--	--	2,354	12,130	1,259
Income from operations.....	52,249	37,941	22,399	7,240	6,207
Interest expense.....	(2,086)	(1,392)	(415)	(1,355)	(1,269)
Other, net.....	589	116	565	(42)	70
Income before income taxes.....	50,752	36,665	22,549	5,843	5,008
Income tax provision(3).....	(19,289)	(13,935)	(3,905)	(639)	(252)
Net income.....	\$ 31,463	\$ 22,730	\$ 18,644	\$ 5,204	\$ 4,756

Pro Forma Data(4)

Basic net income per share (5).....	\$ 1.31	\$ .97	\$ .61	\$ .17
Diluted net income per share (5).....	\$ 1.23	\$ .94	\$ .59	\$ .17

Selected Operating Data:

Active customers(6)...	626,000	732,000	684,000	510,000	424,000
Catalogs distributed..	45,028,000	47,325,000	42,150,000	33,800,000	18,600,000
Orders entered(7).....	1,521,000	1,622,000	1,510,000	1,252,000	910,000
Average order size(7).....	\$ 1,115	\$ 781	\$ 580	\$ 524	\$ 453

December 31,

	2000	1999	1998	1997	1996
--	------	------	------	------	------

(dollars in thousands)

Balance Sheet Data:

Working capital.....	\$ 111,669	\$ 72,250	\$ 53,768	\$ 18,907	\$ 14,622
Total assets.....	250,413	223,537	164,510	105,442	77,358
Short-term debt.....	1,153	1,137	123	29,568	13,057
Long-term debt (less current maturities):					
Capital lease obligations.....	6,792	6,945	7,081	--	--
Term loan.....	--	--	--	3,250	4,250
Note payable.....	1,000	2,000	--	--	--
Total stockholders' equity.....	138,687	94,223	69,676	24,120	18,043

(1) All net sales amounts reflect the reclassification of amounts billed to customers in sales transactions related to shipping and handling as revenue, in accordance with the Emerging Issues Task Force (EITF) consensus on Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." Previously, the Company recorded such charges as a reduction of cost of goods sold.

(2) Represents amounts accrued or distributed in excess of aggregate annual base salaries approved by the Board of Directors prior to the Company's Initial Public Offering and generally represented Company-related federal income tax obligations payable by the stockholders.

(3) For all periods prior to March 6, 1998, the Company had been an S Corporation and, accordingly, had not been subject to federal income taxes.

- (4) Pro forma adjustments have been made to the historical results of operations to make the pro forma presentation comparable to what would have been reported had the Company operated as a C Corporation for 1998 and 1997. The computation of income tax expense was made assuming an effective tax rate of approximately 39%.
- (5) All per share data has been adjusted for a 3-for-2 stock split distributed on May 23, 2000.
- (6) Represents estimates of all customers included in the Company's mailing list who have made a purchase within the last twelve month period.
- (7) Does not reflect cancellations or returns.

## ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's consolidated financial statements.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements based on management's current expectations, estimates and projections about the industry in which the Company operates, management's beliefs and certain assumptions made by management. All statements, trends, analyses and other information contained in this report relative to trends in net sales, gross margin and anticipated expense levels, as well as other statements, including words such as "anticipate", "believe", "plan", "estimate" and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption "Factors That May Affect Future Results and Financial Condition" included within this section. Particular attention should be paid to the cautionary statements involving the industry's rapid technological change and exposure to inventory obsolescence, availability and allocations of goods, reliance on vendor support and relationships, competitive risks, pricing risks, and economic risks. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.

### General

The Company was founded in 1982 as a mail-order business offering a broad range of software and accessories for IBM and IBM-compatible personal computers. The founders' goal was to provide consumers with superior service and high quality branded products at competitive prices. The Company initially sought customers through advertising in selected computer industry publications and the use of inbound toll-free telemarketing. Currently, the Company seeks to generate sales through (i) outbound telemarketing by account managers focused on the business, education and government markets, (ii) inbound calls from customers responding to the Company's catalogs and other advertising and (iii) the Company's Internet Web site.

The Company offers both PC compatible products and Mac compatible products. Reliance on Mac product sales has decreased over the last four years, from 23.0% of net sales in 1996 to 10.3% of net sales for the year ended December 31, 2000. The Company believes that sales attributable to Mac products will continue to decrease as a percentage of net sales and may also decline in absolute dollar volume in 2001 and future years.

All of the Company's product categories experienced strong growth for the year ended December 31, 2000, with sales of networking communications representing the fastest growing category. Sales of networking communications, which generally yield a high gross profit margin percentage, relative to other products, grew by more than 63% in 2000 when compared to 1999. Partially as a result of the higher networking communication sales, the Company's gross margin percentage improved for the year ended December 31, 2000. Sales of computer systems result in a relatively high dollar sales order, as reflected in the increase in the Company's average order size from \$580 in the year ended December 31, 1998 to \$1,115 in the year ended December 31, 2000. Computer systems generally provide the largest gross profit dollar contribution per order of all the Company's products, although they usually yield the lowest gross margin percentage.

The Company's profit margins are also influenced by, among other things, industry pricing and the relative mix of inbound versus outbound sales. Generally, pricing in the computer and related products market is very aggressive, and the Company intends to maintain prices at competitive levels. Since outbound sales are typically to corporate accounts that purchase at volume discounts, the gross margin on such sales is generally lower than inbound sales. However, the gross profit dollar contribution per order is generally higher as average order sizes of orders to corporate accounts are usually larger. The Company believes that outbound sales will continue to represent a larger portion of its business mix in future periods.

The direct marketing of personal computers and related products is highly competitive. In addition to other direct marketers and manufacturers who sell direct, such as Dell and Gateway, manufacturers of PCs sold by the Company, such as Apple, Compaq and IBM, have also announced or implemented varying plans to sell PCs directly to end users. The Company currently believes that direct sales by Compaq and IBM will not have a significant adverse effect upon the Company's net sales.

Most product manufacturers provide the Company with co-op advertising support in exchange for product coverage in the Company's catalogs. Although the level of co-op advertising support available to the Company from certain manufacturers has declined, and may decline further in the future, the overall level of co-op advertising revenues has continued to increase consistent with the Company's increased levels of spending for catalog and other advertising programs. The Company believes that the overall levels of co-op advertising revenues available over the next twelve months will be consistent with the Company's planned advertising programs.

#### Results of Operations

The following table sets forth for the periods indicated information derived from the Company's statements of income expressed as a percentage of net sales.

	Years Ended December 31,		
	2000	1999	1998
Net sales (in millions)	\$1,449.9	\$1,080.8	\$749.9
Net sales.....	100.0%	100.0%	100.0%
Gross profit.....	12.2	12.0	12.4
Selling, general and administrative expenses.....	8.6	8.5	9.1
Additional stockholder/officer compensation.....	0.0	0.0	0.3
Income from operations.....	3.6	3.5	3.0
Interest expense.....	(0.1)	(0.1)	(0.0)
Income before income taxes.....	3.5	3.4	3.0
Income taxes.....	(1.3)	(1.3)	(0.5)
Net income.....	2.2	2.1	2.5
Pro forma net income.....			1.8

The following table sets forth the Company's percentage of net sales by platform, sales channel, and product mix:

	Years Ended December 31,		
	2000	1999	1998
<b>Platform</b>			
PC and Multi Platform.....	90%	85%	81%
Mac.....	10	15	19
Total.....	100%	100%	100%
<b>Sales Channel</b>			
Corporate Outbound.....	76%	65%	53%
Inbound Telesales.....	16	29	43
On-Line Internet.....	8	6	4
Total.....	100%	100%	100%
<b>Product Mix</b>			
Notebooks.....	25%	23%	20%
Desktop/Servers.....	15	15	15
Storage Devices.....	10	10	11
Software.....	10	12	14
Networking Communications.....	8	6	6
Printers.....	7	9	8
Video & Monitors.....	8	8	8
Memory.....	4	4	4
Accessories/Other.....	13	13	14
Total.....	100%	100%	100%

Sales of enterprise server and networking products (included in the above product mix) were 17.4%, 11.6% and 7.3% of net sales for the years ended December 2000, 1999 and 1998, respectively.

#### Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Net sales increased \$369.1 million, or 34.2%, to \$1,449.9 million in 2000 from \$1,080.8 million in 1999. The growth in net sales was attributable to (i) a continued expansion and increased productivity of our outbound telemarketing group, and (ii) an increased focus on enterprise server and networking product categories.

As of December 31, 2000, the number of account managers totaled 575, a 67% increase, compared to 345 account managers at the end of 1999. As a result, outbound sales increased \$394.3 million, or 55.9%, to \$1,099.9 million in 2000 from \$705.6 million in 1999. Enterprise networking product sales increased \$128.0 million, or 102.4%, to \$253.0 million for the year ended December 31, 2000 from \$125.0 million in 1999.

Gross profit increased \$46.9 million, or 36.3%, to \$176.2 million in 2000 from \$129.3 million in 1999. The increase in gross profit dollars was attributable to the increase in net sales described above. Gross profit margin increased from 12.0% in 1999 to 12.2% in 2000 due to a continuing focus on solution sales to business, government and educational customers and an increased focus on higher margin enterprise networking products cited above. The Company's gross margin may vary based upon vendor support programs, product mix, pricing strategies, market conditions and other factors.

Selling, general and administrative expenses increased \$32.6 million, or 35.7%, to \$124.0 million in 2000 from \$91.4 million in 1999 and increased as a percentage of sales to 8.6% in 2000 from 8.5% in 1999. This increase was attributable to increases in sales personnel, bad debt, and facility costs, and offset by a decrease in net advertising expense.

Income from operations increased by \$14.3 million, or 37.7%, to \$52.2 million for the year ended December 31, 2000 from \$37.9 million for the comparable period in 1999. Income from operations as a percentage of net sales increased from 3.5% in 1999 to 3.6% in 2000 for the reasons discussed above.

Interest expense increased by \$.7 million, or 50.0%, to \$2.1 million in 2000 from \$1.4 million in 1999 due to increased borrowings under the Company's line of credit necessitated by the Company's growth. Interest expense is offset by interest income from short-term investments.

The Company's effective tax rate was 38% for both 2000 and 1999.

Net income increased by \$8.8 million, or 38.8%, to \$31.5 million in 2000 from \$22.7 million in 1999, principally as a result of the increase in income from operations.

#### Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Net sales increased \$330.9 million, or 44.1%, to \$1,080.8 million in 1999 from \$749.9 million in 1998. The growth in net sales, which included a 34.6% increase in average order size, was attributable to (i) continued improvements in merchandising and product mix, including the stocking and sale of computer systems; (ii) continued expansion and increased productivity of the Company's outbound telemarketing group; (iii) an increase in the number of catalog mailings; and (iv) sales attributed to the acquisition of ComTeq in June 1999.

Notebook computer systems increased to 23.2% of net sales in 1999 from 20.0% in 1998. Outbound sales increased \$306.7 million, or 76.9%, to \$705.6 million in 1999 from \$398.9 million in 1998. The number of catalogs mailed increased by 12.1%, from 42.2 million catalogs in 1998 to 47.3 million catalogs in 1999.

Gross profit increased \$36.0 million, or 38.6%, to \$129.3 million in 1999 from \$93.3 million in 1998. The increase in gross profit dollars was attributable to the increase in net sales described above. Gross profit margin

decreased from 12.4% in 1998 to 12.0% in 1999 due to a higher rate of growth in sales of lower margin computer systems, increased price competition, decreases in average unit selling prices and an increase in the rate of outbound sales which generally carry a lower gross margin percentage. However, the Company continued to generate higher gross profit dollars per order, enabling it to leverage its operating expenses, as described below. The Company's gross profit margin may vary based upon vendor support programs, product mix, pricing strategies, market conditions and other factors.

Selling, general and administrative expenses increased \$22.9 million, or 33.4%, to \$91.4 million in 1999 from \$68.5 million in 1998, but decreased as a percentage of sales to 8.5% in 1999 from 9.1% in 1998. The increase in expense was attributable to increases in volume-sensitive costs such as sales personnel and credit card fees. The decrease as a percentage of net sales was attributable to the continued leveraging of selling, general and administrative expenses over a larger sales base.

Additional stockholder/officer compensation paid to the Company's two principal stockholders in 1998, who also serve as officers and directors, represented amounts accrued or distributed in excess of aggregate annual base salaries (\$600,000 aggregate base salaries for 1998) approved by the Board of Directors of the Company and generally represent Company-related federal income tax obligations payable by the stockholders. There were no such charges in 1999 as the Company was a C Corporation for the entire year.

Income from operations increased by \$15.5 million, or 69.2%, to \$37.9 million for the year ended December 31, 1999 from \$22.4 million for the comparable period in 1998. Income from operations as a percentage of net sales increased from 3.0% in 1998 to 3.5% in 1999 for the reasons discussed above.

Interest expense increased by \$1.0 million, or 250%, to \$1.4 million in 1999 from \$.4 million in 1998 due to the capital lease obligation for the Merrimack facility which began in December 1998 and increased borrowings under the Company's line of credit.

The tax provision for 1999 reflects a full year of the Company being taxed as a C Corporation. In 1998, the Company's effective tax rate was 17.3% as a result of both its taxation as an S Corporation for a part of the year as well as the recognition of certain deferred tax assets upon conversion to a C Corporation.

Net income increased by \$4.1 million, or 22%, to \$22.7 million in 1999 from \$18.6 million in 1998 due to the result of the increase in income from operations. As described above, 1998 net income was also favorably impacted by the Company's previous S Corporation status and its conversion to a C Corporation.

#### Liquidity and Capital Resources

The Company has historically financed its operations and capital expenditures through cash flow from operations and bank borrowings. The Company believes that funds generated from operations, together with available credit under its bank line of credit, will be sufficient to finance its working capital and capital expenditure requirements at least for the next twelve calendar months. The Company's ability to continue funding its planned growth, both internally and externally, is dependent upon its ability to generate sufficient cash flow from operations or to obtain additional funds through equity or debt financing, or from other sources of financing, as may be required.

At December 31, 2000, the Company had cash and cash equivalents of \$7.4 million and working capital of \$111.7 million.

Net cash used by operating activities was \$4.0 million in the year ended December 2000, compared to \$16.0 million and \$29.4 million provided in the years ended December 31, 1999, and 1998, respectively. The primary factors historically affecting cash flows from operations are the Company's net income and changes in the levels of accounts receivable, inventories and accounts payable. Historically, inventories and accounts payable have increased as a result of the sales growth of the Company. Accounts payable decreased in 2000

due to increased utilization of vendor discounts. Accounts receivable have increased primarily due to an increase in open account sales to commercial customers resulting from the Company's continued efforts to increase its sales to such customers offset in part by a higher rate of increase in accounts receivable allowances for sales returns and doubtful accounts related to the growth in sales.

At December 31, 2000, the Company had \$86.2 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence and will be financed by cash flows from operations or short-term borrowings under the line of credit. This amount includes \$12.1 million payable to two financial institutions under security agreements to facilitate the purchase of inventory.

Capital expenditures were \$12.6 million, \$7.7 million and \$9.9 million in the years ended December 31, 2000, 1999 and 1998, respectively. The Company expects capital expenditures, primarily for the purchase of computer hardware and software and other fixed assets, to be approximately \$8.7 million for the year ending December 31, 2001.

The Company has an unsecured credit agreement with a bank providing for short-term borrowings up to \$70 million, which bears interest at various rates ranging from the prime rate (9.50% at December 31, 2000) to prime less 1%, depending on the ratio of senior debt to EBITDA. The credit agreement includes various customary financial and operating covenants, including restrictions on the payment of dividends, none of which the Company believes significantly restricts its operations. No borrowings were outstanding at December 31, 2000.

In January 2000, the Company used available cash to acquire the Merisel Americas, Inc. call center in Marlborough, Massachusetts. In 1999, it used available cash and sellers notes to acquire ComTeq Federal, Inc., a Maryland-based specialty reseller of computing products to agencies of the federal government. Management could, in the future, use debt, cash, or stock to effect additional acquisitions.

#### Recently Issued Financial Accounting Standards

In June 1998 the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS 133") adjusted to be effective for fiscal years beginning after June 15, 2000. SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company adopted SFAS 133 effective January 1, 2001. The adoption of SFAS 133 did not have a significant impact on the financial position or results of operations of the Company because the Company does not have significant derivative activity.

In December 1999 the Securities and Exchange Commission ("SEC") released Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements." This SAB clarifies certain elements of revenue recognition. Since December 1999, the SEC has issued several amendments that postponed the implementation date to the fourth quarter of fiscal 2000. Implementation of the SAB did not have a material impact on the Company's consolidated financial statements.

In July 2000 the Emerging Issues Task Force reached a consensus on Issue 00-10, "Accounting for Shipping and Handling Fees and Costs". The Consensus specifically stated that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenues earned for the goods provided and should be classified as revenue. It was previously the Company's policy to record such revenues as a reduction of cost of goods sold. The Company adopted this Consensus in the fourth quarter of fiscal 2000. All net sales amounts and gross margin percentages reflect the reclassification of amounts billed to customers in sales transactions related to shipping and handling as revenue for all periods presented.



## Inflation

The Company has historically offset any inflation in operating costs by a combination of increased productivity and price increases, where appropriate. The Company does not expect inflation to have a significant impact on its business in the future.

## Factors That May Affect Future Results and Financial Condition

The Company's future results and financial condition are dependent on its ability to continue to successfully market, sell and distribute computers, hardware and software. Inherent in this process are a number of factors that the Company must successfully manage in order to achieve favorable financial condition and operating results. Potential risks and uncertainties that could affect the Company's future financial condition and operating results include, without limitation, the following factors:

The Company has experienced rapid growth in recent years and there is no assurance that it will be able to manage or sustain such growth.

The Company's net sales have grown from \$340.8 million for the year ended December 31, 1996 to \$1.45 billion for the year ended December 31, 2000. This growth has placed, and any future growth will place, increasing demands on the Company's administrative, operational, financial and other resources. The Company's staffing levels and operating expenses have increased and are expected to increase substantially in the future. The Company also expects that any future growth will continue to challenge its ability to hire, train, motivate and manage employees. If the Company's net sales do not increase in proportion to its operating expenses or if the Company experiences a decrease in net sales, or its information systems do not expand to meet increasing demands, or the Company fails to attract, assimilate and retain qualified personnel or otherwise fails to manage its growth effectively, there would be a material adverse effect on the Company's results of operations.

The Company may experience quarterly fluctuations and seasonality which could impact its business.

Several factors have caused the Company's sales and results of operations to fluctuate, and the Company expects these fluctuations to continue on a quarterly basis. Causes of these fluctuations include:

- . changes in the overall level of economic activity;
- . changes in the level of business investment in information technology products;
- . the condition of the personal computer industry in general;
- . shifts in demand for hardware and software products;
- . industry shipments of new products or upgrades;
- . the timing of new merchandise and catalog offerings;
- . fluctuations in marketing response rates;
- . fluctuations in postage, paper, shipping and printing costs and in merchandise returns;
- . adverse weather conditions that affect response, distribution or shipping;
- . shifts in the timing of holidays; and
- . changes in the Company's product offerings.

The Company bases its operating expenditures on sales forecasts. If revenues do not meet expectations in any given quarter, the Company's operating results could suffer.

In addition, customer response rates to the Company's catalog mailings are subject to variations. The first and last quarters of the year generally have higher response rates while the two middle quarters typically have lower response rates.

The Company is exposed to inventory obsolescence due to the rapid technological changes occurring in the personal computer industry.

The market for personal computer products is characterized by rapid technological change and the frequent introduction of new products and product enhancements. The Company's success depends in large part on its ability to identify and market products that meet the needs of customers in that marketplace. In order to satisfy customer demand and to obtain favorable purchasing discounts, the Company has and may continue to carry increased inventory levels of certain products. By so doing, it is subject to the increased risk of inventory obsolescence. Also, in order to implement its business strategy, the Company intends, among other things, to place larger than typical inventory stocking orders, and increase participation in first-to-market purchase opportunities. In the future, the Company may also participate in end-of-life-cycle purchase opportunities and market products on a private-label basis, which would increase the risk of inventory obsolescence. In addition, the Company sometimes acquires special purchase products without return privileges. There can be no assurance that the Company will be able to avoid losses related to obsolete inventory. In addition, manufacturers are limiting return rights and are also taking steps to reduce their inventory exposure by supporting "build to order" programs authorizing distributors and resellers to assemble computer hardware under the manufacturers' brands. These trends reduce the costs to manufacturers and shift the burden of inventory risk to resellers like the Company which could negatively impact the Company's financial condition.

The Company acquires products for resale from a limited number of vendors; the loss of any one of these vendors could have a material adverse effect on its business.

The Company acquires products for resale both directly from manufacturers and indirectly through distributors and other sources. The five vendors supplying the greatest amount of goods to the Company constituted 54.4% and 50.7% of the Company's total product purchases in the years ended December 31, 2000 and 1999, respectively. Among these five vendors, purchases from Ingram Micro, Inc. represented 25.6% and 21.7% of the Company's total product purchases in the years ended December 31, 2000 and 1999, respectively. Purchases from Tech Data Corporation comprised 11.2% and 7.0% of the Company's total product purchases in the years ended December 31, 2000 and 1999, respectively. No other vendor supplied more than 10% of the Company's total product purchases in the year ended December 31, 2000. If the Company were unable to acquire products from Ingram Micro, Inc., the Company could experience a short-term disruption in the availability of products and such disruption could have a material adverse effect on the Company's results of operations and cash flows.

Substantially all of the Company's contracts and arrangements with its vendors that supply significant quantities of products are terminable by such vendors or the Company without notice or upon short notice. Most of the Company's product vendors provide it with trade credit, of which the net amount outstanding at December 31, 2000 was \$86.2 million. Termination, interruption or contraction of relationships with the Company's vendors, including a reduction in the level of trade credit provided to the Company, could have a material adverse effect on the Company's financial position.

Some product manufacturers either do not permit the Company to sell the full line of their products or limit the number of product units available to direct marketers such as the Company. An element of the Company's business strategy is to increase its participation in first-to-market purchase opportunities. The availability of certain desired products, especially in the direct marketing channel, has been constrained in the past. The Company could experience a material adverse effect to its business if the Company is unable to source first-to-market purchase or similar opportunities, or if the Company faces the reemergence of significant availability constraints.

The Company may experience a reduction in the incentive programs offered to it by vendors.

Some product manufacturers and distributors provide the Company with incentives such as supplier reimbursements, payment discounts, price protection, rebates and other similar arrangements. The increasingly competitive computer hardware market has already resulted in the following:

- . reduction or elimination of some of these incentive programs,
- . more restrictive price protection and other terms; and
- . in some cases, reduced advertising allowances and incentives.

Most product manufacturers provide the Company with co-op advertising support and in exchange the Company covers their products in the Company's catalogs. This support significantly defrays the Company's catalog production expense. In the past, the Company has experienced a decrease in the level of co-op advertising support available to it from certain manufacturers. The level of co-op advertising support the Company receives from some manufacturers may further decline in the future. Such a decline could increase the Company's selling, general and administrative expenses as a percentage of sales and have a material adverse effect on the Company's cash flows.

The Company faces many competitive risks.

The direct marketing industry and the computer products retail business, in particular, are highly competitive. The Company competes with consumer electronics and computer retail stores, including superstores. The Company also competes with other direct marketers of hardware and software and computer related products, including an increasing number of Internet retailers, some of which sell products at or below cost. Certain hardware and software vendors are selling their products directly through their own catalogs and over the Internet. The Company competes not only for customers, but also for co-op advertising support from personal computer product manufacturers. Some of the Company's competitors have greater financial and marketing resources, larger catalog circulations and customer bases, and other resources than does the Company. In addition, many of the Company's competitors offer a wider range of products and services than it does and may be able to respond more quickly to new or changing opportunities, technologies and customer requirements. Many current and potential competitors also have greater name recognition, engage in more extensive promotional activities and adopt more aggressive pricing policies than the Company. The Company expects competition to increase as retailers and direct marketers who have not traditionally sold computers and related products enter the industry.

The Company cannot assure that it can continue to compete effectively against its current or future competitors. In addition, price is an important competitive factor in the personal computer hardware and software market and the Company cannot assure that the Company will not face increased price competition. If the Company encounters new competition or fails to compete effectively against competitors, its business could be adversely affected.

In addition, product resellers and direct marketers are combining operations or acquiring or merging with other resellers and direct marketers to increase efficiency. Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to enhance their products and services. Accordingly, it is possible that new competitors or alliances among competitors may emerge and acquire significant market share.

The Company faces and will continue to face significant and intense price competition.

Generally, pricing is very aggressive in the personal computer industry and the Company expects pricing pressures to continue. An increase in price competition could result in a reduction of the Company's profit margins. There can be no assurance that the Company will be able to offset the effects of price reductions with an increase in the number of customers, higher sales, cost reductions or otherwise. Also, the Company's recent

increase in sales of personal computer hardware products are generally producing lower profit margins than those associated with software products. Such pricing pressures could result in an erosion of the Company's market share, reduced sales and reduced operating margins, any of which could have a material adverse effect on the Company's business.

The methods of distributing computers and related products are changing and such changes may negatively impact the Company and its business.

The manner in which computers and related products are distributed and sold is changing, and new methods of distribution and sale, such as on-line shopping services, have emerged. Hardware and software manufacturers have sold, and may intensify their efforts to sell, their products directly to end-users. From time to time, certain manufacturers have instituted programs for the direct sales of large order quantities of hardware and software to certain major corporate accounts. These types of programs may continue to be developed and used by various manufacturers. Some of the Company's vendors, including Apple, Compaq and IBM, currently sell some of their products directly to end-users and have stated their intentions to increase the level of such direct sales. In addition, manufacturers may attempt to increase the volume of software products distributed electronically to end-users. An increase in the volume of products sold through or used by consumers of any of these competitive programs or distributed electronically to end-users could have a material adverse effect on the Company's results of operations.

The Company could experience system failures which would interfere with its ability to process orders.

The Company depends on the accuracy and proper use of its management information systems including its telephone system. Many of the Company's key functions depend on the quality and effective utilization of the information generated by its management information systems, including:

- . the Company's ability to manage inventory and accounts receivable collection;
- . the Company's ability to purchase, sell and ship products efficiently and on a timely basis; and
- . the Company's ability to maintain operations.

Interruptions could result from natural disasters as well as power loss, telecommunications failure and similar events.

The Company's management information systems require continual upgrades to most effectively manage its operations and customer database. Although the Company maintains some redundant systems, with full data backup, a substantial interruption in management information systems or in telephone communication systems would substantially hinder its ability to process customer orders and thus could have a material adverse effect on the Company's business.

The Company may not have sufficient distribution facilities to support future growth.

The Company's current distribution facilities may be inadequate to support any significant growth in the future. The Company currently occupies two buildings aggregating 205,000 square feet in Wilmington, Ohio under leases which expire in 2002 and 2003. There is no assurance that the Company can renew these leases on favorable terms or at all. The Company is continually assessing its needs for additional distribution facilities. There can be no assurance that suitable commercial facilities will be available, or if available, that such facilities would be available at commercially reasonable rates.

The Company relies on the continued development of electronic commerce and Internet infrastructure development.

The Company's level of sales made over the Internet has increased in part because of the growing use and acceptance of the Internet by end-users. This growth is a recent development. No one can be certain that

acceptance and use of the Internet will continue to develop or that a sufficiently broad base of consumers will adopt and continue to use the Internet and other online services as a medium of commerce. Sales of computer products over the Internet do not currently represent a significant portion of overall computer product sales. Growth of the Company's Internet sales is dependent on potential customers using the Internet in addition to traditional means of commerce to purchase products. The Company cannot accurately predict the rate at which they will do so.

The Company's success in growing its Internet business will depend in large part upon the development of an infrastructure for providing Internet access and services. If the number of Internet users or their use of Internet resources continues to grow rapidly, such growth may overwhelm the existing Internet infrastructure. The Company's ability to increase the speed with which it provides services to customers and to increase the scope of such services ultimately is limited by and reliant upon the speed and reliability of the networks operated by third parties. The Company cannot assure that networks and infrastructure providing sufficient capacity and reliability will continue to be developed.

The Company depends heavily on third-party shippers to deliver its products to customers.

The Company ships approximately 62% of its products to customers by Airborne Freight Corporation D/B/A "Airborne Express", with the remainder being shipped by United Parcel Service of America, Inc. and other overnight delivery and surface services. A strike or other interruption in service by these shippers could adversely affect the Company's ability to market or deliver products to customers on a timely basis.

The Company may experience potential increases in shipping, paper and postage costs, which may adversely effect its business if the Company were not able to pass such increases on to its customers.

Shipping costs are a significant expense in the operation of the Company's business. Increases in postal or shipping rates and paper costs could significantly impact the cost of producing and mailing the Company's catalogs and shipping customer orders. Postage prices and shipping rates increase periodically and the Company has no control over future increases. The Company has a long-term contract with Airborne Express whereby it ships products to the Company's customers. The Company believes that it has negotiated favorable shipping rates with Airborne. The Company generally invoices customers for shipping and handling charges. There can be no assurance that the Company will be able to pass on to its customers the full cost, including any future increases in the cost, of commercial delivery services such as Airborne Express.

The Company also incurs substantial paper and postage costs related to its marketing activities, including producing and mailing its catalogs. Paper prices historically have been cyclical and the Company has experienced substantial increases in the past. Significant increases in postal or shipping rates and paper costs could adversely impact the Company's business, financial condition and results of operations, particularly if the Company cannot pass on such increases to its customers or offset such increases by reducing other costs.

Privacy concerns with respect to list development and maintenance may materially adversely affect the Company's business.

The Company mails catalogs and sends electronic messages to names in its proprietary customer database and to potential customers whose names the Company obtains from rented or exchanged mailing lists. Worldwide public concern regarding personal privacy has subjected the rental and use of customer mailing lists and other customer information to increased scrutiny. Any domestic or foreign legislation enacted limiting or prohibiting these practices could negatively affect the Company's business.

The Company faces many uncertainties relating to the collection of state sales or use tax.

The Company presently collects sales tax only on taxable sales of products to residents of Ohio, Tennessee, Maryland, Massachusetts and Virginia. The Company began collecting sales tax in Massachusetts in

January 2000. Taxable sales to customers located within Ohio, Tennessee, Maryland, Massachusetts and Virginia were approximately 9% of the Company's net sales during the year ended December 31, 2000. Various states have sought to impose on direct marketers the burden of collecting state sales taxes on the sales of products shipped to their residents. In 1992, the United States Supreme Court affirmed its position that it is unconstitutional for a state to impose sales or use tax collection obligations on an out-of-state mail order company whose only contacts with the state are limited to the distribution of catalogs and other advertising materials through the mail and the subsequent delivery of purchased goods by United States mail or by interstate common carrier. However, legislation that would expand the ability of states to impose sales tax collection obligations on direct marketers has been introduced in Congress on many occasions. Due to its presence on various forms of electronic media and other factors, the Company's contact with many states may exceed the contact involved in the Supreme Court case. The Company cannot predict the level of contact that is sufficient to permit a state to impose on us a sales tax collection obligation. If the Supreme Court changes its position or if legislation is passed to overturn the Supreme Court's decision, the imposition of a sales or use tax collection obligation on the Company in states to which the Company ships products would result in additional administrative expenses to the Company, could result in price increases to its customers, and could reduce demand for its product.

The Company is dependent on key personnel.

The Company's future performance will depend to a significant extent upon the efforts and abilities of its senior executives. The competition for qualified management personnel in the computer products industry is very intense, and the loss of service of one or more of these persons could have an adverse effect on the Company's business. The Company's success and plans for future growth will also depend on its ability to hire, train and retain skilled personnel in all areas of its business, including sales account managers and technical support personnel. There can be no assurance that the Company will be able to attract, train and retain sufficient qualified personnel to achieve the Company's business objectives.

The Company is controlled by two principal stockholders.

Patricia Gallup and David Hall, the Company's two principal stockholders, beneficially own or control, in the aggregate, approximately 71% of the outstanding shares of the Company's common stock. Because of their beneficial stock ownership, these stockholders can continue to elect the members of the Board of Directors and decide all matters requiring stockholder approval at a meeting or by a written consent in lieu of a meeting. Similarly, such stockholders can control decisions to adopt, amend or repeal the Company's charter and bylaws, or take other actions requiring the vote or consent of the Company's stockholders and prevent a takeover of the Company by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive the Company's stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of the Company. Such control may result in decisions that are not in the best interest of the Company's public stockholders. In connection with the Company's initial public offering, the principal stockholders placed all except 60,000 of the shares of common stock beneficially owned by them into a voting trust, pursuant to which they are required to agree as to the manner of voting such shares in order for the shares to be voted. Such provisions could discourage bids for the Company's common stock at a premium as well as have a negative impact on the market price of the Company's common stock.

#### ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk

The Company invests cash balances in excess of operating requirements in short-term securities, generally with maturities of 90 days or less. In addition, the Company's unsecured credit agreement provides for borrowings which bear interest at variable rates based on the prime rate. The Company had no borrowings outstanding pursuant to the credit agreement as of December 31, 2000. The Company believes that the effect, if any, of reasonably possible near-term changes in interest rates on the Company's financial position, results of operations and cash flows should not be material.

The Company's credit agreement exposes earnings to changes in short-term interest rates since interest rates on the underlying obligations are variable. The fair value of the Company's credit agreement is not significantly affected by changes in market interest rates, as the change in fair value of the Company's long-term debt resulting from a hypothetical 10% increase or decrease in interest rates is not material.

ITEM 8. Consolidated Financial Statements and Supplementary Data

The information required by this Item is included in this Report beginning at page F-1.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

PART III

ITEM 10. Directors and Executive Officers of the Registrant

The information included under the captions "Information Concerning Directors, Nominees and Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement for its 2001 Annual Meeting of Stockholders to be held on May 24, 2001 (the "Proxy Statement") is incorporated herein by reference. The Company anticipates filing the Proxy Statement within 120 days after December 31, 2000. With the exception of the foregoing information and other information specifically incorporated by reference into this Form 10-K, the Proxy Statement is not being filed as a part hereof.

ITEM 11. Executive Compensation

The information under the caption "Executive Compensation" in the Proxy Statement is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management

The information under the heading "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement is incorporated herein by reference.

ITEM 13. Certain Relationships and Related Transactions

The information under the heading "Certain Transactions and Relationships" in the Proxy Statement is incorporated herein by reference.

PART IV

ITEM 14. Exhibits, Consolidated Financial Statements, Schedule, and Reports on Form 8-K

(a) List of Documents Filed as Part of This Report:

(1) Consolidated Financial Statements

The consolidated financial statements listed below are included in this document.

Consolidated Financial Statements -----	Page References -----
Report of Management.....	F-2
Independent Auditors' Report.....	F-3
Consolidated Balance Sheets.....	F-4
Consolidated Statements of Income.....	F-5
Consolidated Statement of Changes in Stockholders' Equity.....	F-6
Consolidated Statements of Cash Flows.....	F-7
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(2) Consolidated Financial Statement Schedule:

The following Consolidated Financial Statement Schedule of the Company as set forth below is filed with this report:

Schedule -----	Page Reference -----
Schedule II--Valuation and Qualifying Accounts.....	S-1

(3) Supplementary Data

Not applicable.

(b) Reports on Form 8-K

Not applicable.

(c) Exhibits

The exhibits listed below are filed herewith or are incorporated herein by reference to other filings.



EXHIBIT INDEX

Exhibits -----	Page Reference -----
*3.2	Amended and Restated Certificate of Incorporation of Registrant.
*3.4	Bylaws of Registrant.
*4.1	Form of specimen certificate for shares of Common Stock, \$0.01 par value per share, of the Registrant.
*9.1	Form of 1998 PC Connection Voting Trust Agreement among the Registrant, Patricia Gallup individually and as a trustee, and David Hall individually and as trustee.
*10.1	1993 Incentive and Non-Statutory Stock Option Plan, as amended.
*10.2	1997 Stock Incentive Plan.
*10.3	Lease between the Registrant and Miller-Valentine Partners, dated September 24, 1990, as amended, for property located at 2870 Old State Route 73, Wilmington, Ohio.
*10.4	Lease between the Registrant and Gallup & Hall partnership, dated May 1, 1997, for property located at 442 Marlboro Street, Keene, New Hampshire.
*10.5	Lease between the Registrant and Gallup & Hall partnership, dated June 1, 1987, as amended, for property located in Marlow, New Hampshire.
*10.6	Lease between the Registrant and Gallup & Hall partnership, dated July 22, 1998, for property located at 450 Marlboro Street, Keene, New Hampshire.
*10.7	Lease between the Registrant and Dataproducts Corporation, dated June 22, 1993, as amended, for property located at 528 Route 13 South, Milford, New Hampshire.
*10.8	Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1997 for property located at Route 101A, Merrimack, New Hampshire.
*10.9	Employment Agreement between the Registrant and Wayne L. Wilson, dated August 16, 1995.
*10.10	Employment Agreement between the Registrant and Robert F. Wilkins, dated December 23, 1995.
*10.11	Letter Agreement between the Registrant and Airborne Freight Corporation D/B/A "Airborne Express," dated April 30, 1990, as amended.
*10.12	Agreement between the Registrant and Ingram Micro, Inc., dated October 30, 1997, as amended.
*10.13	Employment Agreement, dated as of January 1, 1998, between the Registrant and Patricia Gallup.
*10.14	Form of Registration Rights Agreement among the Registrant, Patricia Gallup, David Hall and the 1998 PC Connection Voting Trust.
**10.15	Amendment No. 1 to Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1998 for property located at Route 101A, Merrimack, New Hampshire.
**10.16	Employment Agreement between the Registrant and John L. Bomba, dated March 28, 1997.
**10.17	Employment Agreement between the Registrant and Mark A. Gavin, dated February 5, 1998.
***10.18	Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
***10.19	Amendment to Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
***10.20	Amendment to Agreement for Wholesale Financing, dated as of November 5, 1999, between the Registrant and Deutsche Financial Services



Exhibits -----	Page Reference -----
***10.21	Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000 between the Registrant and Deutsche Financial Services Corporation.
***10.22	Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc. in connection with the Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between the Registrant and Deutsche Financial Services Corporation.
***10.23	Agreement for Inventory Financing, dated as of August 17, 1999, between the Registrant and IBM Credit Corporation.
***10.24	Amendment to Agreement for Inventory Financing, dated as of February 25, 2000, between the Registrant and IBM Credit Corporation.
***10.25	Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc., PC Connection Sales of Massachusetts, Inc., Merrimack Services Corp. and ComTeq Federal, Inc., in connection with the Amendment to Agreement for Inventory Financing, dated as of February 25, 2000, between the Registrant and IBM Credit Corporation.
***10.26	Agreement for Wholesale Financing, dated as of October 12, 1993, between ComTeq Federal, Inc. and IBM Credit Corporation.
***10.27	Amendment to Agreement for Wholesale Financing, dated as of December 23, 1999, between ComTeq Federal, Inc. and IBM Credit Corporation.
***10.28	Amendment to Addendum to Agreement for Wholesale Financing, dated as of December 23, 1999, between ComTeq Federal, Inc. and IBM Credit Corporation.
***10.29	Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and IBM Credit Corporation.
***10.30	Guaranty, dated as of February 25, 2000, entered into by the Registrant, PC Connection, Inc., PC Connection Sales of Massachusetts, Inc. and Merrimack Services Corp., in connection with the Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and IBM Credit Corporation.
***10.31	Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and Deutsche Financial Services Corporation.
***10.32	Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc. in connection with the Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and Deutsche Financial Services Corporation.
***10.33	Assignment of Lease Agreements, dated as of December 13, 1999, between Micro Warehouse, Inc. (assignor) and the Registrant (assignee).
***10.34	Amended and Restated Credit Agreement, dated February 25, 2000, between PC Connection, Inc., the Lenders Party hereto and Citizens Bank of Massachusetts.
10.35	Amendment, dated January 1, 1999, to the Lease Agreement between the Registrant and Gallup & Hall Partnership, dated June 1, 1987, as amended for property located in Marlow, New Hampshire.
****10.36	Lease between Merrimack Services Corporation and White Knight Realty Trust, dated October 19, 2000 for property located at 7 Route 101A, Amherst, New Hampshire.
10.37	Amendment to Employment Agreement between the Registrant and Robert Wilkins dated December 23, 1995.
10.38	Lease between Merrimack Services Corporation and Schleicher & Schuell, Inc., dated November 16, 2000 for property located at 10 Optical Avenue, Keene, New Hampshire.
10.39	Lease between PC Connection Sales and Dover Mills L.P., dated May 1, 2000 for property located at 100 Main Street, Dover, New Hampshire.
10.40	Lease between Comteq Federal, Inc. and Rockville Office/Industrial Associates dated December 14, 1993 for property located at 7503



Exhibits -----	Page Reference -----
10.41	Amendment, dated November 1, 1996 to the Lease Agreement between ComTek Federal, Inc. and Rockville Office/Industrial Associates for property located in Rockville, Maryland.
10.42	Amendment, dated March 31, 1998 to the Lease Agreement between ComTek Federal, Inc. and Rockville Office/Industrial Associates, dated November 1, 1996, as amended for property located in Rockville, Maryland.
10.43	Amendment, dated August 31, 2000 to the Lease Agreement between ComTek Federal, Inc. and Rockville Industrial Associates, dated March 31, 1998, as amended for property located in Rockville, Maryland.
10.44	Amendment dated June 26, 2000 to the Lease Agreement between Merrimack Services Corporation and EWE Warehouse Investments V, LTD., dated July 31, 1998 for property located at 2840 Old State Route 73, Wilmington, Ohio.
10.45	Lease between PC Connection, Inc. and The Hillsborough Group, dated January 5, 2000 for property located at 706 Route 101A, Merrimack, New Hampshire.
21.1	Subsidiaries of Registrant.
23.1	Consent of Deloitte & Touche LLP.

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 \* Incorporated by reference from the exhibits filed with the Company's registration statement (333-41171) on Form S-1 filed under the Securities Act of 1933.

\*\* Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 31, 1999.

\*\*\* Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K/A Amendment No. 1, File Number 0-23827, filed on April 4, 2000.

\*\*\*\* Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on November 14, 2000.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PC Connection, Inc.

By: /s/ Patricia Gallup

Date: March 30, 2001

-----  
 Patricia Gallup,  
 Chairman and CEO

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name -----	Title -----	Date -----
/s/ Patricia Gallup _____ Patricia Gallup	CEO and Director (Principal Executive Officer)	March 30, 2001
/s/ Wayne L. Wilson _____ Wayne L. Wilson	President and COO (Principal Operating Officer)	March 30, 2001
/s/ Peter J. Baxter _____ Peter J. Baxter	Director	March 30, 2001
/s/ David Beffa-Negrini _____ David Beffa-Negrini	Director	March 30, 2001
/s/ Mark A. Gavin _____ Mark A. Gavin	Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2001
/s/ David Hall _____ David Hall	Vice Chairman and Director	March 30, 2001
/s/ Martin C. Murrer _____ Martin C. Murrer	Director	March 30, 2001

PC CONNECTION, INC. AND SUBSIDIARIES  
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## REPORT OF MANAGEMENT

Responsibility for the integrity and objectivity of the financial information presented in this Annual Report on Form 10-K rests with PC Connection, Inc. and subsidiaries ("the Company") management. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, applying certain estimates and judgments as required.

The Company maintains an effective internal control structure. It consists, in part, of an organization with clearly defined lines of responsibility and delegation of authority, comprehensive systems and control procedures. We believe this structure provides reasonable assurance that transactions are executed in accordance with management authorization and accounting principles generally accepted in the United States of America.

To assure the effective administration of internal control, we carefully select and train our employees, develop and disseminate written policies and procedures, provide appropriate communication channels and foster an environment conducive to the effective functioning of controls. We believe that it is essential for the Company to conduct its business affairs in accordance with the highest ethical standards.

Deloitte & Touche LLP, independent auditors, is retained to audit the Company's consolidated financial statements. Its accompanying report is based on an audit conducted in accordance with auditing standards generally accepted in the United States of America.

The Audit Committee of the Board of Directors is composed solely of outside directors and is responsible for recommending to the Board of Directors the independent accounting firm to be retained for the coming year. The Audit Committee meets periodically and privately with the independent auditors, as well as with Company management, to review accounting, auditing, internal control structure and financial reporting matters.

Patricia Gallup  
Chairman and Chief Executive  
Officer

Wayne L. Wilson  
President and Chief Operating  
Officer

Mark A. Gavin  
Chief Financial  
Officer



INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
PC Connection, Inc. and Subsidiaries  
Merrimack, New Hampshire

We have audited the accompanying consolidated balance sheets of PC Connection, Inc. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. Our audits also included the financial statement schedule listed in Item 14(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PC Connection, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the financial statements, in accordance with Emerging Issues Task Force consensus on Issue 00-10, "Accounting for Shipping and Handling Fees and Costs", the Company has recorded certain reclassifications of amounts billed to customers for shipping and handling fees.

Deloitte & Touche LLP

Boston, Massachusetts  
January 25, 2001

PC CONNECTION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(amounts in thousands, except per share data)

	December 31,	
	----- 2000	1999 -----
	-----	-----
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents.....	\$ 7,363	\$ 20,416
Accounts receivable, net.....	139,644	99,405
Inventories--merchandise.....	54,679	64,348
Deferred income taxes.....	2,175	1,991
Income taxes receivable.....	4,882	1,403
Prepaid expenses and other current assets.....	3,064	3,248
	-----	-----
Total current assets.....	211,807	190,811
Property and equipment, net.....	28,665	23,126
Other assets.....	432	169
Goodwill.....	9,509	9,431
	-----	-----
Total Assets.....	\$250,413	\$223,537
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of capital lease obligation to affiliate.....	\$ 153	\$ 137
Current maturities of long-term debt.....	1,000	1,000
Accounts payable.....	86,216	105,547
Accrued expenses and other liabilities.....	12,769	11,877
	-----	-----
Total current liabilities.....	100,138	118,561
Long-term debt, less current maturities.....	1,000	2,000
Capital lease obligation to affiliate, less current maturities.....	6,792	6,945
Deferred taxes.....	3,555	1,579
Other liabilities.....	241	229
	-----	-----
Total Liabilities.....	111,726	129,314
	-----	-----
Commitments and Contingencies (Note 11)		
Stockholders' Equity:		
Preferred Stock, \$.01 par value, 7,500 shares authorized, 0 outstanding at December 31, 2000 and December 31, 1999....	--	--
Common Stock, \$.01 par value, 30,000 shares authorized, 24,416 and 23,653 issued and outstanding at December 31, 2000 and December 31, 1999, respectively.....	244	237
Additional paid-in capital.....	71,542	58,548
Retained earnings.....	66,901	35,438
	-----	-----
Total Stockholders' Equity.....	138,687	94,223
	-----	-----
Total Liabilities and Stockholders' Equity.....	\$250,413	\$223,537
	=====	=====

See notes to consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME  
(amounts in thousands, except per share data)

	Years Ended December 31,		
	2000	1999	1998
Net sales.....	\$1,449,908	\$1,080,835	\$749,905
Cost of sales.....	1,273,687	951,489	656,631
Gross Profit.....	176,221	129,346	93,274
Selling, general and administrative expenses.....	123,972	91,405	68,521
Additional stockholder/officer compensation.....	--	--	2,354
Income from operations.....	52,249	37,941	22,399
Interest expense.....	(2,086)	(1,392)	(415)
Other, net.....	589	116	565
Income before taxes.....	50,752	36,665	22,549
Income taxes.....	(19,289)	(13,935)	(3,905)
Net income.....	\$ 31,463	\$ 22,730	\$ 18,644
Earnings per common share:			
Basic.....	\$ 1.31	\$ .97	
Diluted.....	\$ 1.23	\$ .94	
Pro forma data:			
Historical income before income taxes.....			\$ 22,549
Pro forma income taxes.....			(8,721)
Pro forma net income.....			\$ 13,828
Pro forma basic net income per share.....			\$ .61
Pro forma diluted net income per share....			\$ .59

See notes to consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
(amounts in thousands)

	Common Stock		Additional	Retained	Total
	Shares	Amount	Paid-In Capital	Earnings	
Balance, December 31, 1997.....	17,699	\$177	\$ 4,038	\$ 19,905	\$ 24,120
Net proceeds from initial public offering.....	5,391	54	57,199	--	57,253
Dividend.....	--	--	(7,196)	(25,841)	(33,037)
Exercise of stock options, including income tax benefits...	318	3	1,396	--	1,399
Compensation under nonstatutory stock option agreements.....	--	--	1,297	--	1,297
Net income.....	--	--	--	18,644	18,644
Balance, December 31, 1998.....	23,408	234	56,734	12,708	69,676
Exercise of stock options, including income tax benefits...	176	2	1,182	--	1,184
Issuance of stock under employee stock purchase plan.....	69	1	470	--	471
Compensation under nonstatutory stock option agreements.....	--	--	162	--	162
Net income.....	--	--	--	22,730	22,730
Balance, December 31, 1999.....	23,653	237	58,548	35,438	94,223
Exercise of stock options, including income tax benefits...	687	6	12,012	--	12,018
Issuance of stock under employee stock purchase plan.....	76	1	931	--	932
Compensation under nonstatutory stock option agreements.....	--	--	51	--	51
Net income.....	--	--	--	31,463	31,463
Balance, December 31, 2000.....	24,416	\$244	\$71,542	\$ 66,901	\$138,687

See notes to consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(amounts in thousands)

	Years Ended December 31,		
	2000	1999	1998
<b>Cash Flows from Operating Activities:</b>			
Net income.....	\$ 31,463	\$ 22,730	\$ 18,644
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Depreciation and amortization.....	6,566	5,334	2,866
Deferred income taxes.....	1,540	2,153	(3,121)
Compensation under nonstatutory stock option agreements.....	51	162	1,297
Provision for doubtful accounts.....	9,868	6,821	6,296
(Gain)/loss on disposal of fixed assets...	(13)	159	--
Changes in assets and liabilities:			
Accounts receivable.....	(49,607)	(42,795)	(35,265)
Inventories.....	9,669	(305)	295
Prepaid expenses and other current assets.....	(3,295)	(504)	(1,910)
Other non-current assets.....	(263)	--	--
Accounts payable.....	(19,077)	19,945	39,387
Amounts payable to stockholders.....	--	--	(1,185)
Income tax benefits from exercise of stock options.....	8,193	370	1,176
Accrued expenses and other liabilities....	897	1,969	926
Net cash provided by (used for) operating activities.....	(4,008)	16,039	29,406
<b>Cash Flows from Investing Activities:</b>			
Purchases of property and equipment.....	(12,581)	(7,653)	(9,922)
Proceeds from sale of property and equipment.....	2,074	2,155	58
Payment for acquisitions, net of cash acquired.....	(2,158)	(3,198)	--
Net cash used for investing activities.....	(12,665)	(8,696)	(9,864)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from short-term borrowings.....	583,042	442,731	160,098
Repayment of short-term borrowings.....	(583,042)	(442,731)	(188,416)
Repayment of notes payable.....	(1,000)	--	(4,500)
Repayment of capital lease obligation to affiliate.....	(137)	(122)	(11)
Issuance of stock upon exercise of nonstatutory stock options.....	3,825	814	223
Issuance of stock under employee stock purchase plan.....	932	471	--
Net proceeds from initial public offering...	--	--	57,253
Payment of dividend.....	--	--	(33,037)
Net cash provided by (used for) financing activities.....	3,620	1,163	(8,390)
Increase (decrease) in cash and cash equivalents.....	(13,053)	8,506	11,152
Cash and cash equivalents, beginning of period.....	20,416	11,910	758
Cash and cash equivalents, end of period....	\$ 7,363	\$ 20,416	\$ 11,910
	=====	=====	=====
<b>Supplemental Cash Flow Information:</b>			
Interest paid.....	\$ 1,923	\$ 1,398	\$ 497
Income taxes paid.....	13,242	9,374	7,275
<b>Non-Cash Activities:</b>			
Issuance of notes payable in connection with acquisition of subsidiary.....	\$ --	\$ 3,000	\$ --
Assets acquired under capital lease.....	--	--	7,215

See notes to consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except per share data)

1. Summary of Significant Accounting Policies

PC Connection, Inc. and subsidiaries (the "Company") is a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, and networking products to business, education, government, and consumer end users located primarily in the United States. The following is a summary of significant accounting policies.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of PC Connection, Inc. and subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the amounts reported in the accompanying consolidated financial statements. Actual results could differ from those estimates.

Revenue Recognition

Revenue on product sales is recognized at the point in time when persuasive evidence of an arrangement exists, the price is fixed and final, delivery has occurred and there is a reasonable assurance of collection of the sales proceeds. The Company generally obtains oral or written purchase authorizations from its customers for a specified amount of product at a specified price and considers delivery to have occurred at the point of shipment. The Company provides its customers with a limited thirty day right of return only for defective merchandise. Revenue is recognized at shipment and a reserve for sales returns is recorded. The Company has demonstrated the ability to make reasonable and reliable estimates of product returns in accordance with SFAS No. 48 based on significant historical experience.

Cash and Cash Equivalents

The Company considers all highly liquid short-term investments with original maturities of 90 days or less to be cash equivalents. The carrying value of the Company's cash equivalents approximates fair value.

Inventories--Merchandise

Inventories (all finished goods) consisting of software packages, computer systems and peripheral equipment, are stated at cost (determined under the first-in, first-out method) or market, whichever is lower. Provisions are made currently for obsolete, slow moving and nonsalable inventory.

Advertising Costs and Revenues

Costs of producing and distributing catalogs are deferred and charged to expense over the period that each catalog remains the most current selling vehicle (generally one to two months) which approximate the period of probable benefits. Other advertising costs are expensed as incurred. Vendors have the ability to place advertisements in the catalogs for which the Company receives advertising allowances and incentives. These revenues are recognized on the same basis as the catalog costs.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Advertising costs charged to expense were \$27,159, \$31,487 and \$32,498 for the years ended December 31, 2000, 1999 and 1998, respectively. Deferred advertising revenues at December 31, 2000, 1999 and 1998 exceeded deferred advertising costs by \$110, \$423 and \$325 at those respective dates.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization is provided for both financial and income tax reporting purposes over the estimated useful lives of the assets ranging from three to seven years. Computer software, including licenses and internally developed software, is capitalized and amortized over lives ranging from three to five years. Depreciation is and has been provided using accelerated methods for property acquired prior to 1996 and on the straight-line method for property acquired thereafter. Leasehold improvements and facilities under capital leases are amortized over the terms of the related leases or their useful lives, whichever is shorter, whereas for income tax reporting purposes, they are amortized over the applicable tax lives. The Company periodically evaluates the carrying value of property and equipment based upon current and anticipated undiscounted cash flows, and recognizes an impairment when it is probable that such estimated future cash flows will be less than the asset carrying value.

Goodwill

Goodwill arises from certain purchase transactions and is amortized using the straight-line method over appropriate periods not exceeding 15 years. The amount charged to expense during 2000 and 1999 was \$704 and \$324, respectively. In certain situations, specifically those where the goodwill is associated with other assets that are subject to impairment losses, goodwill impairment is assessed relative to undiscounted cash flows. In other situations where goodwill is considered to be associated with the entire enterprise, impairment is assessed based on undiscounted enterprise cash flows.

Tax Status and Income Taxes

For periods prior to March 6, 1998, the Company elected to be treated as an S Corporation under Subchapter S of the Internal Revenue Code (the "Code"), and applicable state laws. Effective with the consummation of the Company's initial public offering of its common stock on March 6, 1998 (the "Offering"), the Company's S Corporation election was automatically terminated and the Company became subject to federal and state income taxes as a C Corporation from that date forward.

Deferred income tax assets and liabilities are computed for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized. "Income taxes" as presented on the Consolidated Statements of Income comprise the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Additional Stockholder/Officer Compensation

Additional stockholder/officer compensation represents amounts accrued or distributed in excess of aggregate annual base salaries approved by the Board of Directors (the "Board") and generally represents Company-related federal income tax obligations payable by the stockholders for period during which the Company was an S Corporation.



PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Concentration of Credit Risk

Concentrations of credit risk with respect to trade account receivables are limited due to the large number of customers comprising the Company's customer base. Ongoing credit evaluations of customers' financial condition are performed.

Earnings Per Share

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding adjusted, when dilutive, for the incremental shares attributed to outstanding options to purchase common stock. The denominator for pro forma basic earnings per share for the period prior to March 6, 1998 includes the weighted average shares required to pay the S Corporation dividend (assuming a price per share of \$11.67 for the year ended December 31, 1998).

The following table sets forth the computation of basic and diluted earnings per share:

	2000	1999	Pro Forma 1998
	-----	-----	-----
(amounts in thousands, except per share data)			
Numerator:			
Net income.....	\$31,463	\$22,730	\$13,828
Denominator:			
Denominator for basic earnings per share:			
Weighted average shares.....	24,054	23,475	22,274
Weighted average shares required to pay stockholder dividend.....	--	--	474
Denominator for basic earnings per share.....	24,054	23,475	22,748
Effect of dilutive securities:			
Employee stock options.....	1,518	692	756
Denominator for diluted earnings per share.....	25,572	24,167	23,504
	=====	=====	=====
Earnings per share:			
Basic.....	\$ 1.31	\$ .97	\$ .61
	=====	=====	=====
Diluted.....	\$ 1.23	\$ .94	\$ .59
	=====	=====	=====

The above pro forma adjustment has been made to the historical results of operations for the period from January 1 through March 5, 1998 to make the pro forma presentation comparable to what would have been reported had the Company operated as a C Corporation. The computation of income tax expense was made assuming an effective tax rate of approximately 39%.

The following options to purchase Common Stock were excluded from the computation of diluted earnings per share for years ended December 31, 2000, 1999, and 1998 because the effect of the options on the calculation would have been anti-dilutive:

	2000	1999	1998
	-----	-----	-----
Anti-dilutive stock options.....	97	--	117

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Stock-Based Compensation

Compensation expense associated with awards of stock or options to employees and directors is measured using the intrinsic value method in accordance with APB Opinion No. 25. The Board estimated the fair value of the Company's stock for awards made prior to the Offering using market valuations of comparable publicly traded companies, among other factors.

Comprehensive Income

The Company has no other comprehensive income in any of the periods presented. Accordingly, a separate statement of comprehensive income is not presented.

Recently Issued Financial Accounting Pronouncements

In June 1998 the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS 133") adjusted to be effective for fiscal years beginning after June 15, 2000. SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company adopted SFAS 133 effective January 1, 2001. The adoption of SFAS 133 did not have a significant impact on the financial position or results of operations of the Company.

In December 1999 the Securities and Exchange Commission ("SEC") released Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements." This SAB clarifies certain elements of revenue recognition. Since December 1999, the SEC has issued several amendments that postponed the implementation date to the fourth quarter of fiscal 2000. Implementation of the SAB did not have a material impact on the Company's consolidated financial statements.

In July 2000, the Emerging Issues Task Force reached a consensus on Issue 00-10, "Accounting for Shipping and Handling Fees and Costs". The Consensus specifically stated that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenues earned for the goods provided and should be classified as revenue. It was previously the Company's policy to record such revenues as a reduction of cost of goods sold. The Company adopted this Consensus in the fourth quarter of fiscal 2000. All net sales amounts and gross margin percentages reflect the reclassification of amounts billed to customers in sales transactions related to shipping and handling as revenue.

Reclassifications

Certain amounts in the 1999 and 1998 financial statements have been reclassified to conform to the 2000 presentation.

2. Acquisitions

On January 4, 2000 the Company acquired the Merisel Americas Inc. call center in Marlborough, Massachusetts for approximately \$2,200 including acquisition costs. The Company acquired the assembled work force of Merisel, as well as its fixed assets; it also assumed its lease liabilities. The excess of the purchase price over the fair value of the assets acquired totaled approximately \$1,300. Such excess will be amortized over a period of 15 years.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

On June 29, 1999, the Company acquired all of the outstanding stock of ComTeq Federal, Inc., a supplier of computer equipment and services to federal government agencies. The purchase price was \$8,300, including acquisition costs and consisted of cash of \$5,300 and promissory notes aggregating \$3,000. Total cash paid for ComTeq Federal Inc., net of cash acquired, was \$3,200. The transaction has been accounted for by the purchase method, and accordingly, the results of operations for the period from June 29, 1999 are included in the accompanying financial statements. The assets purchased and liabilities assumed have been recorded at their fair value at the date of acquisition. The excess of the purchase price, including acquisition costs, over the fair value of the liabilities assumed has been recorded as goodwill (approximately \$9,700). Goodwill will be amortized over a period of 15 years. The promissory notes are unsecured, bear interest at the prime rate less 0.5% and are scheduled to be repaid over a three year period. As of December 31, 2000, the short-term portion of the promissory notes was \$1,000 and the long-term portion was \$1,000.

Pro Forma Information

The following unaudited pro forma information presents the consolidated results of operations of the Company as if the acquisition of ComTeq Federal, Inc. had taken place as of the beginning of each of the periods presented. Merisel results prior to the acquisition have not been included because of their immateriality.

	Years Ended December 31,	
	1999	1998
	(in thousands except per share data)	
Revenues.....	\$ 1,105,664	\$ 787,102
Net income.....	23,350	14,647
Diluted earnings per share.....	.97	.62

3. Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2000	1999
Trade.....	\$134,682	\$96,981
Co-op advertising.....	4,243	2,965
Vendor returns, rebates and other.....	9,847	7,109
Total.....	148,772	107,055
Less allowances for:		
Sales returns.....	(3,592)	(3,717)
Doubtful accounts.....	(5,536)	(3,933)
Accounts receivable, net.....	\$139,644	\$99,405
	=====	=====

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

4. Property and Equipment

Property and equipment consisted of the following:

	December 31,	
	2000	1999
Facilities under capital lease.....	\$ 7,215	\$ 7,215
Leasehold improvements.....	4,730	5,337
Furniture and equipment.....	25,711	22,923
Computer software, including licenses and internally- developed software.....	18,645	10,749
Automobiles.....	266	224
Total.....	56,567	46,448
Less accumulated depreciation and amortization.....	(27,902)	(23,322)
Property and equipment, net.....	<u>\$28,665</u>	<u>\$23,126</u>

5. Bank Borrowings

At December 31, 2000, the Company had an unsecured credit agreement with a bank providing for short-term borrowings up to \$70,000 which bears interest at various rates ranging from the prime rate (9.50% at December 31, 2000) to prime rate less 1% depending on the ratio of senior debt to EBITDA (earnings before interest, taxes, depreciation and amortization). The credit agreement includes various customary financial and operating covenants, including minimum net worth requirements, minimum net income requirements and restrictions on the payment of dividends, none of which the Company believes significantly restricts the Company's operations. No amounts were outstanding under this facility at December 31, 2000. The credit agreement matures on May 31, 2002.

Certain information with respect to short-term borrowings were as follows:

	Weighted Average Interest Rate	Maximum Amount Outstanding	Average Amount Outstanding
Year ended December 31,			
2000.....	8.2%	\$55,000	\$9,567
1999.....	7.4	29,543	4,497
1998.....	8.2	28,307	4,145

6. Trade Credit Arrangements

At December 31, 2000 and 1999, the Company had security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow a collateralized position in inventory financed by the financial institutions up to an aggregated amount of \$60,000. The cost of such financing under these agreements is borne by the suppliers. At December 31, 2000 and 1999, accounts payable included \$12,136 and \$31,064, respectively owed to these financial institutions.

7. Capital Lease

In November 1997, the Company entered into a fifteen-year lease for a new corporate headquarters with an affiliated company related to the Company through common ownership. The Company occupied the facility upon completion of construction in late November 1998, and the lease payments commenced in December 1998. Annual lease payments under the terms of the lease, as amended, are approximately \$911 for the first five

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

years of the lease, increasing to \$1,025 for years six through ten and \$1,139 for years eleven through fifteen. The lease requires the Company to pay its proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. The Company has the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease.

Future aggregate minimum annual lease payments under this lease at December 31, 2000 are as follows:

Year Ending December 31 -----	Payments -----
2001.....	\$ 911
2002.....	911
2003.....	921
2004.....	1,025
2005.....	1,025
2006 and thereafter.....	8,688
	-----
Total minimum payments (excluding taxes, maintenance and insurance).....	13,481
Less amount representing interest.....	(6,536)
	-----
Present value of minimum lease payments.....	6,945
Less current maturities.....	(153)
	-----
Long-term portion.....	\$ 6,792
	=====

8. Stockholders' Equity

Formation of Holding Company

On January 1, 2000, the Company formed a new holding company structure to support PC Connection's future growth and plans to expand its current business lines through internal growth and potential acquisitions.

Outstanding shares of common stock representing interests in PC Connection prior to the holding company formation were converted into shares of the new holding company on a one-for-one basis through a non-taxable transaction. Common stock shares of the new holding company trade on the Nasdaq National Market under the symbol, "PCCC", the same exchange and symbol used by the predecessor company. The new shares hold the same voting power that shares of the predecessor held. No additional capital stock was issued as part of the transaction. The directors and officers of the predecessor company serve as the directors and officers of the new holding company.

Stock Split

In April 2000, the Company's Board of Directors approved a three-for-two stock split of its outstanding shares of Common Stock to be effected in the form of a 50% stock dividend. The dividend was distributed on May 23, 2000 to the Company's stockholders of record as of the close of business on May 12, 2000. All per share and related amounts contained in these financial statements and notes have been adjusted retroactively to reflect the stock split.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Preferred Stock

The Amended and Restated Certificate of Incorporation of the Delaware Corporation (the "Restated Certificate") authorized the issuance of up to 7,500,000 shares of preferred stock, \$.01 par value per share (the "Preferred Stock"). Under the terms of the Restated Certificate, the Board is authorized, subject to any limitations prescribed by law, without stockholder approval, to issue by a unanimous vote such shares of Preferred Stock in one or more series. Each such series of Preferred Stock shall have such rights, preferences, privileges and restrictions, including voting rights, dividend rights, redemption privileges and liquidation preferences, as shall be determined by the Board. There were no preferred shares outstanding at 2000 and 1999.

Incentive and Non-Statutory Stock Option Plans

In December 1993, the Board adopted and the stockholders approved the 1993 Incentive and Non-Statutory Stock Option Plan (the "1993 Plan"). Under the terms of the 1993 Plan, the Company is authorized to make awards of restricted stock and to grant incentive and non-statutory options to employees of, and consultants and advisors to, the Company to purchase shares of the Company's stock. A total of 1,686,245 shares of the Company's Common Stock was authorized for issuance upon exercise of options granted or awards made under the 1993 Plan. Options vest over varying periods up to four years and have contractual lives up to ten years.

In November 1997, the Board adopted and the stockholders approved the 1997 Stock Incentive Plan (the "1997 Plan"), which became effective on the closing of the Offering. The 1997 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, performance shares and awards of restricted stock and unrestricted stock. A total of 3,000,000 shares have been reserved for issuance under this Plan.

Information regarding the 1993 and 1997 Plans is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Fair Value
	-----	-----	-----
Outstanding, December 31, 1997.....	1,641,015	\$ 2.21	
Granted.....	1,170,545	11.85	5.41
Exercised.....	(318,972)	.70	
Forfeited.....	(84,233)	5.11	
	-----		
Outstanding, December 31, 1998.....	2,408,355	7.02	
Granted.....	714,832	10.36	4.29
Exercised.....	(175,903)	4.62	
Forfeited.....	(124,674)	9.02	
	-----		
Outstanding, December 31, 1999.....	2,822,610	7.93	
	-----		
Granted.....	626,415	30.27	15.78
Exercised.....	(687,653)	5.56	
Forfeited.....	(111,864)	13.35	
	-----		
Outstanding, December 31, 2000.....	2,649,508	13.61	
	=====		

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

The following table summarizes the status of outstanding stock options as of December 31, 2000:

Exercise Price Range	Options Outstanding			Options Exercisable	
	No. of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	No. of Shares	Weighted Average Exercise Price
\$ .51	257,893	3.11	\$ .51	257,893	\$ .51
\$ .51-\$2.54	96,294	4.96	1.30	91,378	1.52
\$3.81	211,433	5.13	3.81	177,504	3.81
\$8.92	343,454	8.73	8.92	62,611	8.92
\$9.98	10,000	9.96	9.98	0	0
\$11.33	3,750	8.10	11.33	0	0
\$11.67	1,037,090	6.48	11.67	598,503	11.67
\$11.83-\$16.83	102,516	7.87	13.53	11,767	13.56
\$18.33	251,076	9.06	18.33	0	0
\$20.33-\$20.58	67,500	9.07	20.56	1,875	20.33
\$25.25	48,000	9.80	25.25	0	0
\$27.25-\$50.00	20,000	9.52	34.67	0	0
\$51.81	182,502	9.54	51.81	0	0
\$52.75-\$62.19	18,000	9.64	53.54	0	0
<u>\$ .51-\$62.19</u>	<u>2,649,508</u>	<u>6.97</u>	<u>\$13.61</u>	<u>1,201,531</u>	<u>\$ 7.21</u>

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". Accordingly, compensation expense for options awarded under the Plans in 2000, 1999 and 1998, has been recognized using the intrinsic value method.

The fair value of options granted prior to the consummation of the Offering was estimated using the minimum value method and risk-free interest rates and expected option lives of 6% and seven years, respectively. The minimum value pricing method was designed to value stock options of non-public companies; accordingly, the minimum value method assumed zero volatility.

The Black-Scholes model was used to value options granted subsequent to the Offering using a volatility factor of 69%, 50%, and 50% for 2000, 1999 and 1998, respectively, estimated option lives of four years, and a risk-free interest rate of 6.4% for 2000 and 6.0% for 1999 and 1998, respectively. Management believes that the assumptions used and the models applied to value the awards yield a reasonable estimate of the fair value of the grants made under the circumstances, given the alternatives under SFAS No. 123.

Effective upon the consummation of the Offering, certain restrictions as to the exercise of options granted under the Company's 1993 Plan expired. Prior to the consummation of the Offering, the Company recorded compensation expense for certain options granted at prices less than their fair market value ratably over seven years from the dates granted, because such options were not exercisable except upon the occurrence of certain events, including a public offering of the Company's Common Stock. Effective upon the consummation of the Offering, the Company recorded a one-time charge for stock-option compensation expense of approximately \$870, relating to the acceleration of the vesting period of certain of the Company's stock options from seven to four years.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Compensation expense charged to operations using the intrinsic value method totaled \$51, \$162 and \$1,297 (including the one-time charge of \$870 referred to above), for the years ended December 31, 2000, 1999, and 1998, respectively. Had the Company recorded compensation expense using the fair value method under SFAS No. 123, pro forma net income and diluted net income per share for the years ended December 31 would have been as follows:

	Pro Forma		
	----- 2000	----- 1999	----- 1998
	-----		
Net income, as reported.....	\$31,463	\$22,730	\$13,828
Net income, under SFAS No. 123.....	29,414	21,511	12,979
Diluted net income per share, as reported.....	1.23	.94	.59
Diluted net income, under SFAS No. 123.....	1.15	.89	.55

1997 Employee Stock Purchase Plan

In November 1997, the Board adopted and the stockholders approved the 1997 Employee Stock Purchase Plan (the "Purchase Plan"), which became effective on February 1, 1999. The Purchase Plan authorizes the issuance of Common Stock to participating employees. Under the terms of the Purchase Plan, the purchase price is an amount equal to 85% of the fair market value per share of the Common Stock on either the first day or the last day of the offering period, whichever is lower. An aggregate of 337,500 shares of Common Stock has been reserved for issuance under the Purchase Plan, of which 145,000 shares were purchased.

9. Income Taxes

The provision for income taxes prior to March 6, 1998 was based on the state income tax obligations of the Company as an S Corporation. Effective with the consummation of the Offering, the Company's S Corporation election was terminated and the Company began to account for income taxes as a C Corporation.

The 2000, 1999 and 1998 provision for income taxes and unaudited 1998 pro forma provision for income taxes consisted of the following:

	Years Ended December 31,			
	----- 2000	----- 1999	----- 1998	----- (Pro Forma) 1998
	-----			
Paid or currently payable:				
Federal.....	\$16,673	\$10,373	\$ 6,390	\$6,882
State.....	1,526	1,409	842	680
Total current.....	18,199	11,782	7,232	7,562
Deferred:				
Recognition of deferred tax asset upon termination of S Corporation election.....	--	--	(4,200)	--
Federal.....	1,004	1,983	795	1,054
State.....	86	170	78	105
Net deferred.....	1,090	2,153	(3,327)	1,159
Net provision.....	\$19,289	\$13,935	\$ 3,905	\$8,721
	=====	=====	=====	=====



PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

The components of the deferred taxes at December 31, 2000 and 1999 are as follows:

	2000	1999
	-----	-----
Current:		
Provisions for doubtful accounts.....	\$ 2,104	\$ 1,456
Inventory costs capitalized for tax purposes.....	442	519
Inventory and sales returns reserves.....	887	1,221
Deductible expenses, primarily employee-benefit related....	61	114
Other liabilities.....	(1,319)	(1,319)
	-----	-----
Net deferred tax asset.....	2,175	1,991
	-----	-----
Non-Current:		
Compensation under non-statutory stock option agreements...	426	670
Excess of book basis over tax basis of property and equipment.....	(3,981)	(2,249)
	-----	-----
Net deferred tax liability.....	(3,555)	(1,579)
	-----	-----
Net deferred tax asset (liability).....	\$(1,380)	\$ 412
	=====	=====

The reconciliation of the Company's 2000, 1999 and 1998 income tax provision and its 1998 unaudited pro forma income tax provision to the statutory federal tax rate is as follows:

	2000	1999	1998	(Pro Forma) 1998
	----	----	----	-----
Statutory tax rate.....	35.0%	35.0%	35.0%	35.0%
Recognition of deferred tax asset upon termination of S Corporation election.....	--	--	(18.6)	--
1998 S Corporation income not subject to federal income taxes.....	--	--	(2.8)	--
State income taxes, net of federal benefit.....	2.5	2.6	2.6	2.6
Nondeductible expenses.....	0.4	0.2	0.2	0.2
Other--net.....	0.1	0.2	0.9	0.9
	-----	-----	-----	-----
Effective income tax rate.....	38.0%	38.0%	17.3%	38.7%
	====	====	=====	====

10. Employee Benefit Plan

The Company has a contributory profit-sharing and employee savings plan covering all qualified employees. No contributions to the profit-sharing element of the plan were made by the Company in 2000, 1999 or 1998. The Company made matching contributions to the employee savings element of the plan of approximately \$592, \$317 and \$361 in 2000, 1999 and 1998, respectively.

11. Commitments and Contingencies

Operating Leases

The Company leases certain office facilities from its principal stockholders under 20-year noncancelable operating leases. The lease agreement for one facility requires the Company to pay all real estate taxes and insurance premiums related thereto. The Company also leases several other buildings from its principal stockholders on a month-to-month basis.

In addition, the Company leases office and distribution facilities and equipment from unrelated parties with remaining terms of one to six years.

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Future aggregate minimum annual lease payments under these leases at December 31, 2000 are as follows:

Year Ending December 31 -----	Related Parties	Others	Total -----
2001.....	\$179	\$4,968	\$5,147
2002.....	149	3,434	3,583
2003.....	134	1,609	1,743
2004.....	134	592	726
2005.....	134	246	380
2006 and thereafter.....	338	12	350

Total rent expense aggregated \$3,936, \$1,470 and \$1,521 for the years ended December 31, 2000, 1999 and 1998, respectively, under the terms of the leases described above. Such amounts included \$169, \$189 and \$327 in 2000, 1999 and 1998, respectively, paid to related parties.

Contingencies

The Company is subject to various legal proceedings and claims which have arisen during the ordinary course of business. In the opinion of management, the outcome of such matters is not expected to have a material effect on the Company's financial position, results of operations and cash flows.

12. Other Related Party Transactions

Other related-party transactions include the transactions summarized below. Related parties consist primarily of affiliated companies related to the Company through common ownership.

	Year Ended December 31, -----		
	2000	1999	1998 -----

Revenue:

Sales of various products.....	\$ 3	\$ 1	\$13
Sales of services to affiliated companies.....	300	332	--
Costs:			
Purchase of services from affiliated companies.....	9	6	2

13. Segment and Related Disclosures

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," requires that public companies report profits and losses and certain other information on its "reportable operating segments" in its annual and interim financial statements.

Management has determined that the Company has only one "reportable operating segment," given the financial information provided to and used by the "chief decision maker" of the Company to allocate resources and assess the Company's performance. However, senior management does monitor revenue by platform (PC vs. Mac), sales channel (Inbound Telesales, Corporate Outbound, On-line Internet), and product mix (Notebooks, Desktops and Servers, Storage Devices, Software, Networking Communications, Printers, Video and Monitors, Memory, Accessories and Other).

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

Net sales by platform, sales channel, and product mix are presented below:

	Year Ended December 31,		
	2000	1999	1998
<b>Platform</b>			
PC and Multi Platform.....	\$1,300,453	\$ 919,543	\$604,635
Mac.....	149,455	161,292	145,270
<b>Total.....</b>	<b>\$1,449,908</b>	<b>\$1,080,835</b>	<b>\$749,905</b>
<b>Sales Channel</b>			
Corporate Outbound.....	\$1,099,879	\$ 705,580	\$398,948
Inbound Telesales.....	237,013	314,622	320,847
On-Line Internet.....	113,016	60,633	30,110
<b>Total.....</b>	<b>\$1,449,908</b>	<b>\$1,080,835</b>	<b>\$749,905</b>
<b>Product Mix</b>			
Notebooks.....	\$ 365,067	\$ 250,801	\$149,738
Desktop/Servers.....	211,505	165,325	117,196
Storage Devices.....	139,406	109,675	82,189
Software.....	149,982	129,484	107,493
Networking Communications.....	113,022	69,065	43,940
Printers.....	103,125	99,287	59,986
Video & Monitors.....	117,602	81,805	58,263
Memory.....	58,465	38,318	28,802
Accessories/Other.....	191,734	137,075	102,298
<b>Total.....</b>	<b>\$1,449,908</b>	<b>\$1,080,835</b>	<b>\$749,905</b>

Included in the product mix sales are enterprise networking product sales of \$253,000, \$125,000 and \$55,000 for the years ended December 2000, 1999 and 1998, respectively.

Substantially, all of the Company's net sales in 2000, 1999 and 1998 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in 2000, 1999 and 1998. All of the Company's assets at December 31, 2000 and 1999 were located in the United States. The Company's primary target customers are small- to medium-size businesses ("SMBs") comprised of 20 to 1,000 employees, although its customers also include individual consumers, larger companies, federal, state and local governmental agencies and educational institutions. No single customer other than federal government accounted for more than 3% of total net sales in 2000. Net sales to the federal government in 2000 and 1999 were \$129,200 or 8.9% of total net sales and \$81,400 or 7.7% of total net sales, respectively. No single customer (including the federal government) accounted for more than 1% of total net sales in 1998.

14. Selected Unaudited Quarterly Financial Results

The following table sets forth certain unaudited quarterly data of the Company for each of the quarters since January 1999. This information has been prepared on the same basis as the annual financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the selected quarterly information when read in conjunction with the annual financial statements and the notes thereto included elsewhere in this document. The quarterly operating

PC CONNECTION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)  
(amounts in thousands, except per share data)

results are not necessarily indicative of future results of operations. See "Factors That May Affect Future Results and Financial Condition--Historical Net Losses; Variability of Quarterly Results."

	Quarters Ended			
	March 31, 2000	June 30, 2000	Sept. 30, 2000	Dec. 31, 2000
	(in thousands, except per share data)			
Net sales.....	\$333,799	\$366,090	\$404,876	\$345,143
Cost of sales.....	293,169	321,145	355,146	304,227
Gross profit.....	40,630	44,945	49,730	40,916
Selling, general and administrative expenses.....	29,007	30,903	32,872	31,190
Income from operations.....	11,623	14,042	16,858	9,726
Interest expense.....	(340)	(334)	(440)	(972)
Other, net.....	204	165	121	99
Income before income taxes.....	11,487	13,873	16,539	8,853
Income tax provision.....	(4,368)	(5,272)	(6,284)	(3,365)
Net Income.....	\$ 7,119	\$ 8,601	\$ 10,255	\$ 5,488
Weighted average common shares outstanding:				
Basic.....	23,676	23,926	24,243	24,364
Diluted.....	24,879	25,556	25,897	25,471
Earnings per common share:				
Basic.....	\$ .30	\$ .36	\$ .42	\$ .23
Diluted.....	\$ .29	\$ .34	\$ .40	\$ .22

	Quarters Ended			
	March 31, 1999	June 30, 1999	Sept. 30, 1999	Dec. 31, 1999
	(in thousands, except per share data)			
Net sales.....	\$230,633	\$237,456	\$288,176	\$324,570
Cost of sales.....	203,567	209,657	253,724	284,541
Gross profit.....	27,066	27,799	34,452	40,029
Selling, general and administrative expenses.....	19,763	20,040	24,333	27,269
Income from operations.....	7,303	7,759	10,119	12,760
Interest expense.....	(266)	(276)	(449)	(401)
Other, net.....	94	47	32	(57)
Income before income taxes.....	7,131	7,530	9,702	12,302
Income tax provision.....	(2,710)	(2,862)	(3,687)	(4,676)
Net Income.....	\$ 4,421	\$ 4,668	\$ 6,015	\$ 7,626
Weighted average common shares outstanding:				
Basic.....	23,433	23,441	23,477	23,546
Diluted.....	24,102	24,092	24,117	24,683
Earnings per common share:				
Basic.....	\$ .19	\$ .20	\$ .26	\$ .32
Diluted.....	\$ .18	\$ .19	\$ .25	\$ .31



PC CONNECTION, INC. AND SUBSIDIARIES  
SCHEDULE II--VALUATION AND QUALIFYING ACCOUNTS  
(amounts in thousands)

Description -----	Balance at Beginning of Period -----	Charged to Costs and Expenses -----	Deductions- Write-Offs -----	Balance at End of Period -----
Allowance for Sales Returns				
Year Ended December 31, 1998....	\$2,701	\$70,434	\$(69,105)	\$4,030
Year Ended December 31, 1999....	4,030	68,215	(68,528)	3,717
Year Ended December 31, 2000....	3,717	67,321	(67,446)	3,592
Allowance for Doubtful Accounts				
Year Ended December 31, 1998....	2,659	6,296(1)	(3,834)	5,121
Year Ended December 31, 1999....	5,121	6,821(1)	(8,009)	3,933
Year Ended December 31, 2000....	3,933	9,868(1)	(8,265)	5,536
Inventory Valuation Reserve				
Year Ended December 31, 1998....	1,896	6,017	(5,323)	2,590
Year Ended December 31, 1999....	2,590	5,350	(6,099)	1,841
Year Ended December 31, 2000....	1,841	5,651	(5,792)	1,700

-----  
(1) Additions to the provision for doubtful accounts include charges to advertising and cost of sales aggregating \$2,863, \$1,037 and \$3,063 for the years ended December 31, 2000, 1999, and 1998, respectively. Such allowances relate to receivables under cooperative arrangements with vendors.

AMENDMENT TO LEASE

This Amendment, with an effective date of January 1, 1999, modifies the Lease entered into June 1, 1987, as previously amended from time to time by and between Gallup & Hall Partnership with offices at 730 Milford Road, Merrimack, New Hampshire (Landlord) and PC Connection, Inc., a Delaware corporation with offices at 730 Milford Road, Merrimack, New Hampshire (Tenant) for premises known as the Christmas Trees Inn, situated on Route 10 in Marlow, New Hampshire, as follows:

Item Sec. Amend or Replace the Indicated Lease Section as follows:

- 
1. 3 Delete and replace with: "Tenant shall pay as rent to the Landlord, the sum of \$500.00 per month, payable in advance, during the term of this Lease."

All other provisions of the Lease shall continue in full force and effect.

Agreed: Gallup & Hall, LLP

By: /s/  
Patricia Gallup, Partner

PC Connection, Inc.  
By: /s/  
Wayne Wilson, President

MEMORANDUM

To: Robert Wilkins

From: Patricia Gallup, Chairman and CEO

Date: March 1, 1999

Re: Amendment to Employment Agreement

This memo serves as an amendment to the agreement we entered into upon the commencement of your employment with PC Connection, Inc. Should your employment be terminated for any reason other than cause as defined in the original agreement, you will receive one full year of base salary rather than six months of base salary.

Bob, I believe you will find this change in line with the discussions we have had regarding this issue.

Signed: /s/ Patricia Gallup



## LEASE

This LEASE made November 16, 2000 by and between Schleicher & Schuell, Inc., a Delaware corporation with offices at 10 Optical Avenue, Keene, NH 03431(hereinafter "Landlord"), and Merrimack Services Corporation, a Delaware corporation with offices at 730 Milford Road, Merrimack, New Hampshire 03054 (hereinafter "Tenant").

WHEREAS, Landlord owns a certain building known as 10 Optical Avenue, Keene, New Hampshire; and

WHEREAS, Tenant desires to lease certain space in said building (the "Premises"),

NOW, THEREFORE, in consideration of the mutual covenants contained herein, the parties agree as follows:

1. PREMISES. Landlord agrees to lease to Tenant the Premises, comprising an area of 10,374 square feet, more or less, located at 10 Optical Avenue, Keene, New Hampshire. Tenant may sublease the Premises, or portions thereof, to its affiliated corporations provided it remains liable to Landlord for the rent.
2. TERM. The term of this Lease shall be five (5) years, commencing upon completion of renovations (see Schedule "A") and delivery of the Premises to Tenant, which shall be evidenced by a Certificate of Occupancy issued by the City of Keene.
3. OPTION. Landlord hereby grants to Tenant two (2) additional two-year extensions to this Lease, at Tenant's sole option. Tenant may exercise said options by providing Landlord with written notice of its intent to exercise the options no later than ninety (90) days before the termination of the Lease or any subsequent extension.
4. RENT.

(a) Tenant shall pay rent to Landlord at a rate of \$11.75 per square foot per annum, or \$121,894.50 per annum, paid in 12 equal monthly installments of \$10,157.88 on the 1/st/ day of each month during the initial term of this Lease, less the following amount: The final actual total of Column B on Attachment A, divided by 5 years, divided by 10,374 square feet. In addition,

tenant shall pay, as additional rent, the sum of \$1,000.00 per month for the parking described in paragraph 15. Annually, on the anniversary date of this Agreement, the Landlord may increase the monthly parking rate per CPI, not to exceed 5%.

(b) During the first option term, if exercised, Tenant shall pay rent to Landlord at a rate of \$11.75 per square foot per annum, or \$121,894.50 per annum, subject to annual increase in accordance with CPI, not to exceed 5%, paid in 12 equal monthly installments on the 1st day of each month during first option term of this Lease.

(c) During the second option term, if exercised, Tenant shall pay at a per annum rate established for prior option term plus adjustment per CPI.

5. DEPOSIT. A deposit consisting of an amount equal to one (1) month's rent shall be paid commensurate with the payment of the first monthly rental payment. This deposit shall be applied towards the last month's rent.

6. RENOVATIONS. Landlord authorizes tenant to contract services of others to renovate the space defined by Attachment A, including "selective demolition, new wall construction, ceilings, flooring, ADA compliant restrooms, electrical/mechanical systems, fire protection and room finishes, in accordance with architectural documents to be developed and attached to this document as Attachment B. For the sake of expediting this effort, the budget values identified in Attachment A shall be used to calculate the reduction of lease rate commensurate with the tenants investment in initiation renovation of the premises. Upon completion of the renovation, the reduced lease rate may be adjusted via amendment, to reflect actual costs incurred.

7. OPERATIONS. The parties agree that each shall furnish and pay for the cost of operations as indicated below:

To be furnished by:

- (a) Utilities (electricity, heat, water, sewer, phone).
- (b) Trash removal.
- (c) Replacement of bulbs and fluorescent tubes.
- (d) Window washing.
- (e) Replacement of broken glass.

Tenant  
Tenant  
Tenant  
Landlord  
Landlord

- |   |          |
|---|----------|
| (f) Janitorial and cleaning services.   | Tenant   |
| (g) All maintenance and repairs to the Premises including HVAC .  | Landlord |
| (h) Common area costs, including clearing and removal of ice and snow from walkways, parking lot area and roof when necessary for safety, sanding, and grounds maintenance. | Landlord |
| (i) Structural integrity of the roof and buildings and replacement of any part of the HVAC system when necessary.   | Landlord |
| (j) Parking lot maintenance, including asphalt sealing and repair and re-striping.  | Landlord |
| (k) Maintenance and repair of fuel storage tanks including any underground fuel storage tanks.  | Landlord |

7. INSURANCE.

(a) Landlord shall maintain all-risk property insurance on the Premises in at least the amount of the replacement value of the Premises. Landlord shall also maintain combined bodily injury and property damage insurance on said property in an amount not less than Five Hundred Thousand Dollars (\$500,000.00) and One Million Dollars (\$1,000,000.00) in aggregate. Insurance policies shall be issued by financially responsible insurers authorized to do business in the State of New Hampshire.

(b) Tenant shall maintain liability insurance on its business and operations on the Premises, in an amount of not less than Five Hundred Thousand Dollars (\$500,000.00) per incident and One Million Dollars (\$1,000,000.00) in aggregate. Insurance policies shall be issued by financially responsible insurers authorized to do business in the State of New Hampshire.

(c) Each party shall provide the other party of evidence of insurance upon execution of this Lease and thereafter upon request.

8. TAX. Landlord shall pay all real estate taxes when due. In the event Landlord fails to pay any such tax or related charges when due, Tenant shall have the option to pay such tax and related charges and deduct said amounts from its rent payments.

9. LANDLORD'S REMEDIES. Landlord may deem Tenant to be in breach of this Lease following any of the following events, upon written notice to Landlord:

(a) If Tenant fails to pay rent or other charges and assessments when due and payable under this Lease within ten (10) days following written notice of failure to pay;

(b) If Tenant fails to commence to cure any other violation of its covenants within twenty (20) days following written notice thereof or, having commenced to cure, fails to conclude such cure with reasonable diligence; and

(c) Upon the adjudication of Tenant as a bankrupt or the appointment of a receiver of its property.

10. UNFITNESS. If the Premises, or any portion thereof, are made unfit by fire, the elements, or other casualty, rent for the leased Premises, or affected portion thereof, shall abate from the date of such casualty until its restoration to fitness. Landlord shall restore the Premises with all reasonable speed and, if Landlord does not restore the Premises or the affected portion thereof to fitness within one hundred twenty (120) days, Tenant may terminate this Lease. If the Premises are more than fifty percent (50%) destroyed by such casualty, either Landlord or Tenant may terminate this Lease unless Landlord is able to rebuild and restore the premises within one hundred twenty (120) days of such casualty. Rent shall abate during such period of unfitness.

11. INSPECTION. Landlord shall have the right upon reasonable notice to enter the premises during normal business hours for reasonable inspections and, in addition, shall have the right to show the Premises to prospective tenants during the last 60 days of the term, provided the Landlord and its guests are accompanied by Tenant.

12. LANDLORD'S IMPROVEMENTS.

(a) Landlord shall have the right at its own expense to re-landscape and make cosmetic changes to the Premises during the term of the Lease. Any such work will be coordinated with Tenant so that business operations of the Tenant will not be disturbed and security of the Premises is not compromised.

(b) Landlord may at its own expense place a "for lease" sign on the property if the Tenant does not exercise the option to extend this Lease.

13. SIGNS. Landlord must approve in advance of installation any signs, lettering or plaques that Tenant desires to affix to the building, doors, windows, or any exterior part of the Premises. Such approval shall not be unreasonably withheld.

14. TENANT'S ALTERATIONS AND IMPROVEMENTS. Except for the fix-up work described herein, Tenant shall not make any alterations or improvements to the Premises without the prior written consent of Tenant, which consent shall not be unreasonably withheld.

15. PARKING.

(a) Landlord shall provide on the Premises the required parking spaces for Tenant and its employees and guests. These spaces shall be for the use of Tenant's employees on the Premises, as well as employees and guests of the Tenant's 450 Marlboro Street facility.

16. EFFECT OF TERMINATION. Upon termination of this Lease, or any extension thereof, any and all improvements, alterations or modifications that are affixed to the real estate, and normally considered to be part of the real estate, shall become the property of the Landlord. This includes, but is not limited to, ceilings, flooring, carpeting, shelving (which is affixed to the real estate), partitions, walls, wall coverings and the like. Upon termination of this Lease, Tenant may remove its own personal property not considered fixtures, such as Venetian blinds, curtains, office equipment, business machines, trade fixtures, signs and the like.

17. CONDEMNATION. If the leased Premises, or any significant portion thereof, are taken by eminent domain, or condemned for public use, this Lease may be terminated upon written

notice by either Landlord or Tenant, and any and all awards for such taking shall be the exclusive property of the Landlord; provided, however, that nothing contained herein shall be construed to preclude Tenant from prosecuting any claim directly against the condemning authority in such condemnation proceedings for loss of business or depreciation or, damage to, or cost of removal of, or the value of stock and other personal property belonging to the Tenant; provided, however, that no such claim shall diminish or otherwise adversely affect Landlord's award or the award of any mortgagee.

18. SUCCESSORS AND ASSIGNS. This Lease is binding on the parties hereto and their respective heirs, executors, administrators, successors and assigns. This Lease may be assigned by Tenant to its parent, subsidiary, or sister corporations, provided that Tenant shall remain obligated to make all payments required hereunder.

19. ENTIRE AGREEMENT. This Lease embodies the entire agreement between the parties, and there are no promises, terms, conditions or obligations referring to the subject matter herein other than those contained herein. There may be no modification of this Lease except in writing, executed by both Landlord and Tenant with the same formalities as this Lease.

20. GOVERNING LAW. This Lease shall be construed under the laws of the State of New Hampshire.

Agreed:

Schleicher & Schuell, Inc.

Merrimack Services Corporation

By: /s/ Peter Konstantin  
-----

By: /s/ Wayne L. Wilson  
-----

Peter Konstantin,  
President, General Manager

Wayne Wilson, President

Legal Dept.

/s/ ILLEGIBLE  
-----

Attachment A

Renovations to 10,374 square feet at 10 Optical Avenue, Keene, NH

Task - - - - -	Column A Budget Value -----	Column B Credit Toward Rent -----
Architectural Development	\$ 14,800.00	\$ 0.00
General Conditions (Supervision, dump fees, demolition)	\$ 15,740.00	\$ 15,740.00
Sitework (walkway, landscaping)	\$ 9,550.00	\$ 0.00
Concrete (floor patches/trenching)	\$ 1,700.00	\$ 1,700.00
Masonry (for new entry)	\$ 1,200.00	\$ 0.00
Masonry (for restroom - ADA - needs)	\$ 2,800.00	\$ 2,800.00
Roof (curbs/penetrations)	\$ 6,500.00	\$ 6,500.00
Carpeting	\$ 27,800.00	\$ 0.00 *
Carpentry (partitions, ceilings, painting)	\$ 50,790.00	\$ 25,395.00
Carpentry (cabinets)	\$ 5,400.00	\$ 0.00
New Entry	\$ 8,800.00	\$ 0.00
Mechanical Systems (plumbing/HVAC)	\$186,160.00	\$186,160.00
Electrical (power, lighting)	\$ 42,900.00	\$ 42,900.00
Electrical (power distribution to workstations)	\$ 15,000.00	\$ 0.00
Fire Protection (sprinkler system)	\$ 16,975.00	\$ 16,975.00
Contingency	\$ 5,000.00	\$ 5,000.00
	<b>\$411,115.00</b>	<b>\$303,170.00</b>

Values listed are Budget Values only. Actual costs to be confirmed via competitive pricing and resulting credit toward rent shall be adjusted according via amendment to Lease upon completion of renovations. Landlord and Tenant agree to work collectively to control cost of renovation effort.

Using budget values shown above, the credit toward rent, on a per square foot basis, shall be as follows:  
 $\$303,170.00 / 5 \text{ years} / 10,374 \text{ sf} = \$5.84/\text{sf}$

Final Actual Amount: \$5.84

\*Denotes budget amount. Actual cost shall be calculated at 50% of carpentry cost incurred.

## LEASE AGREEMENT

Lease made the first day of May, 2000, by and between Dover Mills L.P., Joseph Sawtelle Enterprises, Inc., General Partner, Joseph Sawtelle, President, hereinafter referred to as "Lessor", and PC Connection Sales Corporation, hereinafter referred to as "Lessee".

## WITNESSETH

That the Lessor, for and in consideration and upon the terms, conditions, and provisions hereinafter set forth, does hereby agree to lease to the Lessee, its successors, heirs, and assigns, the following described premises: 45,474 square feet of space at the Cocheco Falls Millworks, 100 Main Street, Dover, New Hampshire. The leased premises are described as follows:

Space A: 31,666 sq/ft on 2nd floor Mill 3  
Space B: 13,808 sq/ft on first floor, southerly side of Mill 3

1. TERM. The term of this lease for Space A shall be for five (5) years, beginning on May 1, 2000, and ending on April 31, 2005. The term of this lease for Space B shall be for three (3) years beginning May 1, 2000 and ending on April 31, 2003. For both leases, Lessee shall have the option to renew this Lease Agreement for one (1) additional five (5) year option period. If the Lessee has not vacated the leased premises at the close of the lease or any option period, it shall be considered a holdover tenant and shall serve at the will of the Lessor. As such, Lessee shall be governed by the same terms and obligations as set forth herein.

2. RENT. The Lessee agrees to pay to the Lessor as rent for the leased premises for the first year of this Lease Agreement a sum based on the following schedule:

May 1, 2000	-	\$ 27,707.75
June 1, 2000	-	\$ 27,707.75
July 1, 2000	-	\$ 39,789.75
August 1, 2000	-	\$ 39,789.75

September 2000 through April 2001 - Rent shall be adjusted by the increase of the Boston Metro Region Consumer Price Index (CPI) from the preceding twelve months or five (5%), whichever is less.

All rents shall be forwarded to Dover Mills LLC. C/o Joseph Sawtelle, 5 Greenleaf Woods, Suite 102, Portsmouth, New Hampshire 03801. The rent for each subsequent year of the initial lease term and any option period shall be adjusted by the increase of the Boston Metro Region Consumer Price Index (CPI) from the preceding twelve months or five (5%), whichever is less.

Rent shall be paid to the Lessor on the first day of each and every calendar month. If the rent of any other payment due Lessor from Lessee has not been received by the Lessor within ten (10) days after notice on non-payment from Lessor, then Lessee shall be charged a late payment penalty equal to 10% of the late payment. If additional space is leased over the term of the lease agreement, Lessee shall pay Lessor an amount similar to the rental rate currently being paid on the initial leased space and with the same term requirements.



3. IMPROVEMENTS BY LESSOR. The above-described leased premises shall be leased to the Lessee "as is".

4. IMPROVEMENTS BY LESSEE. Lessee shall be fully responsible for all other improvements to the leased premises not specified above. Said improvements shall include, but not be limited to: telephone and data distribution, electrical distribution in addition to that currently available, signage, lighting and door locks.

5. MASTER KEY. Lessee shall provide Lessor with one copy of an entry key for use by the Lessor to gain emergency access into the leased premises.

6. LIENS. Lessee shall keep all of the leased premises and Dover Mills, L.L.C. free and clear of mechanics', materialmen's and other liens in connection with work and/or labor done or services provided to the leased premises by Lessee.

7. UTILITIES. Lessee shall be solely responsible for the cost of electricity. Lessor shall install a sub meter (demand and conventional metering) on the electrical service that serves the leased premises. Lessor shall read the meter every thirty (30) days and Lessee shall be responsible for reimbursing Lessor for usage. Lessee shall reimburse Lessee within seven (7) days from the date the invoice is received.

Lessee shall be solely responsible for cost associated in heating/cooling the leased premises. The Lessee agrees to pay to Lessor a heating/cooling charge of \$1.00 per square foot. A monthly heating/cooling charge of \$3,789.50 shall be paid Lessor along with the rental payment. A credit of \$38.35 shall be given to Lessee for every day the space remains closed prior to occupancy. All HVAC will be shut down until occupancy begins. Lessee shall notify Lessor is HVAC is needed before such time as occupancy begins.

The \$1.00 per square foot HVAC charge shall remain fixed over the initial lease term. The building standard for heating/cooling runs between 68-72 degrees.

8. ALTERATIONS. All planned improvements by the Lessee within the leased premises shall be reviewed and approved by the Lessor prior to their undertaking, which approval Lessor shall not unreasonably withhold. All improvements shall meet the rules and regulations and applicable Code requirements that are in force by local and State development and building authorities. Lessor reserves the right to enter onto the leased premises, at reasonable times after reasonable prior notice, to inspect, maintain, and construct/expand the buildings utility infrastructure. Any planned expansion of utilities within the leased premises shall first be reviewed with the Lessee and any construction will be scheduled so as not to impede or disrupt business activities.

9. MAINTENANCE. Lessor shall be responsible for all exterior repairs to the building to include, but not necessarily limited to structural, roof walls, and HVAC units. Lessor shall be responsible for installing doors and windows in the leased premises that are in good working order.

Lessee shall, however, be responsible for their repairs (windows, glass, and doors) necessitated by Lessee's usage, reasonable wear and tear excluded. Lessee shall be solely responsible for keeping the leased premises clean at all times in the manner of a first class office space. Lessor shall be responsible for all snow and ice clearing of on-site parking spaces and walkways. Lessor shall keep all interior common access ways free and clear of debris and in a clean state. Exterior grounds shall also be adequately maintained, with landscaping kept trimmed and neat by the Lessor.

10. PROPERTY OF LESSEE. It is hereby covenanted and agreed between the parties hereto that unless otherwise stipulated by agreement in writing from time to time, all trade fixtures, machinery, and equipment installed on the leased premises by the Lessee shall be deemed to be the property of the Lessee. Accordingly, Lessor hereby waives all its rights, title, and interest in and to the same at the expiration thereof, except that Lessor does not waive the rights of attachment of the same if Lessee be in default of its covenants at the time of such expiration or termination, and written notice of such default shall have been given by the Lessor to the Lessee not less than thirty (30) days before the end of the term hereof. At the termination of this Lease Agreement such improvements or alterations as may have been made by the Lessee may be removed therefrom at Lessee's own expense, except such alterations or improvements that are integral to the structural and/or infra structural integrity of the leased premises or the building at large. At the termination of this Lease Agreement all improvements or alterations so characterized shall revert to the Lessor at no cost to or payment by the Lessor. Lessee shall have access to all common areas of the building. Lessor shall subordinate its rights contained herein to any bank or financial institution which requires a security interest in the assets of the Lessee.

11. DESTRUCTION OF PREMISES. In case said leased premises or any substantial part thereof shall at any time during the term of this Lease Agreement be so destroyed or damaged by fire and/or water or other unavoidable casualties as to be unfit for occupation or use by Lessee for Lessee's business, then the rent, herein before reserved, or a fair and just proportion thereof, according to the nature and extent of the damage sustained, shall be suspended and cease to be payable until said premises are rebuilt and put in proper condition by said Lessor for use and occupancy by said Lessee; provided that unless the Lessor shall give to the Lessee written notice of its intention to rebuild/reconstitute said premises within fifteen (15) days after such destruction or damage, the Lessee shall have the option by written notice to the Lessor given within ten (10) days after the expiration of fifteen (15) days from such destruction or damage to cancel and terminate this Lease Agreement. In case Lessor shall have given such written notice of its intention to rebuild, it shall proceed to rebuild as soon as reasonably possible, but Lessee may terminate this Lease Agreement if the premises are not tenant able by Lessee for the carrying on of its business within thirty (30) days after the receipt of such notice from Lessor.

Lessor agrees to provide Lessee with comparable workspace within the Millworks, provided said space is available, for use as temporary workspace. Said space shall be made available to Lessee while reconstruction takes place.

12. HOLD HARMLESS. The Lessee covenants and agrees with the Lessor that Lessee will

indemnify and save harmless the Lessor from any and all reasonable loss, cost, damage and expense pertaining to, connected with, or resulting from the use and occupancy of the leased premises by the Lessee or arising out of lessees negligence, and any accident or other occurrence causing injury to any person or to property by reason of or in connection with the use and occupation of the demised premises by said Lessee, or Lessee's agents, employees, or guests, or which may arise out of business which the Lessee may carry on in said demised premises. It is understood that the provisions of this section do not apply to any loss, cost damage or expense attributable to the negligent, intentional or tortuous acts or omissions of the Lessor, its agents, employees or assigns and Lessor hereby agrees to indemnify and save Lessee harmless from same.

13. USE OF PREMISES. The Lessee covenants and agrees that the Lessee will not carry on therein any offensive trade or business, not do any act, not transact any business by which the insurance on said premises may be affected. With respect to acts or transactions as a result of which the insurance on said premises may be affected, Lessee shall consult in advance with Lessor who in turn shall consult with its insurers for a determination of the facts and to resolve whether said acts or transactions shall be undertaken, and if any additional insurance cost or coverage is required it shall be at the expense of the Lessee. Lessee shall be responsible for the increase in insurance above use for normal business offices that results from the Lessee's use of the premises. Lessor shall bill the Lessee for the additional insurance cost and Lessee shall pay the bill within seven (7) days of its receipt.

14. PEACEFUL ENJOYMENT. The Lessor covenants and agrees with the Lessee that the Lessee, paying the rent herein reserved and observing, keeping and performing the covenants and agreements herein contained, and on the Lessee's part to be observed, kept and performed, shall and may peaceably and quietly have, hold, occupy, possess and enjoy the demised premises and all of the rights, privileges, easements and fixtures thereto belonging for and during the full term of this Lease Agreement. Lessor agrees to obtain a non-disturbance agreement reasonably satisfactory to Lessee.

15. SURRENDER OF PREMISES. The Lessee covenants and agrees with the Lessor that at the expiration or sooner termination of the lease or renewal or extension thereof, the Lessee will quietly and peaceably surrender up possession of the demised premises to the Lessor in as good a condition as the demised premises were in the beginning of this lease, ordinary wear and tear or damage by fire or other casualty excepted.

16. SUBORDINATION. This Lease Agreement shall be subject to any mortgage that now effects the demised premises or that the Lessor or any owner of the premises may hereafter at any time elect to place on such premises, and to all advances already made or that may be hereafter made on account of any such mortgage, to the full extent of the principal sum secured thereby and interest thereon. Furthermore, Lessee shall on request hereafter execute any paper or papers that Lessor's counsel may reasonably deem necessary to accomplish such subordination of Lessee's interest in this Lease. Lessor agrees to obtain a non-disturbance agreement with respect to any mortgage to which

this Lease agreement is subordinated.

17. DEFAULT. If the Lessee either:

- (a) Shall fail to pay to Lessor any installment of rent due, and such default shall continue for ten (10) days after receipt of written notice from Lessor; or
- (b) Shall fail to comply with any other covenant or obligation on its part to be performed hereunder and shall fail within forty five (45) days after receipt by Lessee from Lessor of written notice specifying the nature of such default, either to cure such default or in good faith and with reasonable diligence to commence remedy of such default, then in either such event Lessor may at its option either:
  - (i) Terminate the possession and right of possession of Lessee, and in such case Lessee shall be liable for and shall pay the Lessor damages in an amount equal to any rent past due on the date of such termination; or
  - (ii) Take possession of said property and rent the same as agent for and for the account of the Lessee, in which case the Lessee shall be liable for and shall pay to the Lessor the difference between the rent herein stipulated and the amount, if any, for which the Lessor is able to re-rent said property;
  - (iii) Terminate this Lease Agreement and take possession of the property.

(c) If the Lessee shall be adjudged to be bankrupt or shall make as assignment for the benefit of creditors, or if a receiver of the property of the Lessee in or upon said leased premises be appointed in any action (accept a stockholder dispute), suit or proceedings by or against the Lessee, voluntarily or involuntarily, then in such event Lessor may at its option either:

- (i) Terminate the possession and right of possession of Lessee, and in such case Lessee shall be liable for and shall pay the Lessor damages in an amount equal to any rent past due on the date of such termination; or
- (ii) Take possession of said property and rent the same as agent for and for the account of the Lessee, in which case the Lessee shall be liable for an shall pay to the Lessor the difference between the rent herein stipulated and the amount, if any, for which the Lessor is able to re-rent said property,
- (iii) Terminate this Lease Agreement and take possession of the property.

18. ASSIGNMENT. It is hereby covenanted and agree between the parties, hereto, that Lessee shall be permitted to assign this Lease Agreement to any other party given Lessor's written consent, said consent shall not be unreasonably withheld. Lessor shall make its decision based on the financial strength of the proposed sublet party and on the basis of the proposed use of the premises. Lessor agrees to respond to any request to assign or sublet within five (5) business days. Lessor grants Lessee the right to assign the Lease to a wholly owned subsidiary of Lessee, consent by Lessor shall not be unreasonably withheld.

19. LOADING DOCK USE. Lessee shall be permitted to utilize the loading dock located

in Mill 3. The loading dock shall be kept clear at all times and maintained in a clean, debris-free state. Lessor shall maintain the loading dock in good repair.

20. INSURANCE. The Lessee shall procure and maintain in force at Lessee's expense during the term of this lease and any extension thereof public liability insurance. Such insurance shall be adequate against liability for damage claims through public use or arising out of accidents occurring in the leased premises, in an amount not less than \$1,000,000.00 combined single limits. The insurance policies shall provide coverage for contingent liability of Lessor on any claims or losses. All insurance provided by the Lessee as required by this section shall be carried in favor of Lessor (as additional insured, but only as respects operations of Lessee) and Lessee as their respective interest may appear. All policies shall require ten (10) days notice to Lessor of any cancellation or change effecting any interest of Lessor. If the insurance policies are not kept in force during the term of this lease or any extension thereof, Lessor may procure the necessary insurance and pay the premium thereof, and the premium shall be repaid to the Lessor as an additional rent installment for the month following the date on which the premiums were paid by Lessor.

21. NOTICE. Any notice required under the terms of this Lease Agreement shall be sent by certified mail or hand delivered to the signers of this Lease Agreement. The address of the Lessor is Dover Mills L.L.C., c/o Joseph Sawtelle, 5 Greenleaf Woods, Suite 102, Portsmouth, New Hampshire, 03801.

22. NOISE, SMOKE, ETC. The Lessee agrees that in conducting Lessee's business in or on the premises by itself or those in Lessee's employ, due regard shall be given to limiting the noise and vibration generated by such business operation. The discharge of smoke, soot, fumes, vapors, waste material, or other irritants, contaminants, or pollutants into or upon the premises, land, the atmosphere, sewer connections or pipes, or any water course or adjacent body of water shall not be permitted. The Lessee represents that with respect to the operation of the Lessee's business there shall be no discharge from Lessee's operation which would adversely affect the property of others, including, but not limited to property of the City of Dover including its sewer system and water/sewer treatment facility. Furthermore, in the event the Lessee's operation in or on the leased premises shall cause damage to such property of others, the Lessee agrees to save the Lessor harmless from any claims, liability, costs, attorney's fees, or exposure arising out of or in connection with such damage.

23. MISUSE. The Lessee agrees to be responsible and pay for all damages and assessments, and or other charges to the City of Dover for any misuse made or suffered on the premises by the Lessee, or its agents or employees.

24. SECURITY DEPOSIT. The Lessor shall waive security deposit for Lessee.

25. INTEGRATION. This Lease set forth the entire agreement by the parties, and no custom, act, forbearance or words or silence at any time by any party shall waive or release either party from any default in the performance or fulfillment of any obligation or liability or operate against either party as a supplement, alteration, amendment or change of any term or provision set forth herein, including this clause, unless set forth in written instrument duly executed by both parties stating that

it is intended to impose such an additional obligation or liability or to constitute such a waiver or release, or that it is intended to operate as such supplement, alteration, amendment or change.

26. INVALID PROVISIONS. If any term or provision of this Lease Agreement or the application thereof to any person, property or circumstance shall to any extent be invalid or unenforceable, the remainder of this Lease Agreement, or the application of such term or provisions to person or property and circumstances other than as to which it is invalid or unenforceable, shall not be affected thereby, and each term and provision of this Lease Agreement shall be valid and enforced to the full extent permitted by law.

The provisions of the Indenture and Lease Agreement shall be binding upon the inure to the benefit of the successors and assigns of the Lessor and Lessee.

27. OPTION TO RENEW. Written notice of the exercise of the option to renew this Lease Agreement by the Lessee shall be given to the Lessor at least 120 days prior to the expiration of the original term or the expiration of the term of an option period previously exercised and provided that said option may be exercised by Lessee only in the event that rents or other payments due Lessor as set forth by this Lease Agreement (including any applicable grace periods) have been paid in full and that all material provisions of this Lease Agreement have been fully observed. A new Lease Agreement shall be unnecessary as this agreement constitutes a present demise for the original and any extended terms.

28. SOLID WASTE. Lessor shall require Lessee to remove any solid waste/trash generated from business operations.

29. PARKING. Lessor shall reserve sixty (60) parking spaces. Fifty (50) shall be allocated in the lower level of the Steam Plant parking lot, two in the upper level of the Steam Plant parking lot, and eight (8) in the Central Towers parking lot. Lessee shall be solely responsible for erecting signs to reserve said spaces, the size and character of which shall be reviewed and approved by the Lessor. Lessor shall be responsible for snow and ice clearance. The balance of the parking shall be provided for in the off-site Chestnut Street parking lot. Said parking is accessible by Lessor's 34 seat trolley that operates between the hours of 6:00 AM - 8:30 PM, five days a week.

30. HOURS OF OPERATION. Lessee shall have access to the leased space twenty-four hours a day, 365 days a year.

31. CAFETERIA SERVICE. Lessee shall have use of the third floor cafeteria between the hours of 7:00 AM - 2:00 PM.

32. The Lessor grants to Lessee. The option to furnish and install an emergency generator in one of the following locations, immediate to the leased premises: roof top of existing structure; within the existing structure; or a pad mounted at ground level. Lessee shall bear the

coordination, design (including structural assessment if appropriate), and installation of the generator system. Final layout of the system shall be subject to lessor's approval, which shall not be unreasonably withheld.

33. Lessee hereby agrees to pay to lessor a monthly fee of \$3,425.00 for that portion of the trolley service that runs from 9:30 AM - 3:30 PM and from 7:30PM-8:30PM. This fee shall be paid along with all other required payments at the beginning of each and every calendar month. The hours that Lessee pays for may be adjusted by Lessee at an increase/decrease rate of \$425.00 per month/hour, provided written notice is given to Lessor thirty (30) days prior to said adjustment.

IN WITNESS WHEREOF, the parties do hereby agree to the terms and conditions of this Lease Agreement on the day and year first written above.

DOVER MILLS LCC  
Joseph Sawtelle Enterprises, Inc.

/s/ T. C. Sheldon  
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Witness

/s/ Joseph Sawtelle  
-----  
Joseph Sawtelle, President

PC CONNECTION SALES CORPORATION

/s/ R. A. Pratt  
-----  
Witness

/S/ Robert Wilkins, President  
-----  
Duly Authorized

7503 Standish Place  
Rockville, Maryland 20855  
4,169 square feet            618811-01

AGREEMENT OF LEASE

THIS AGREEMENT OF LEASE (hereinafter referred to as "this Lease"), made this 14th day of December, 1993, by and between ROCKVILLE OFFICE/INDUSTRIAL ASSOCIATES, a limited partnership organized and existing under the law of Texas having an address at c/o Trammell Crow Company, 3500 Trammell Crow Center, 2001 Ross Avenue, Dallas, TX 75201-2997 (hereafter referred to as "the Landlord"), and COMTEQ FEDERAL, INC., a corporation organized and existing under the law of Maryland having an address at 7503 Standish Place, Rockville, Maryland (hereinafter referred to as "the Tenant").

WITNESSETH, THAT FOR AND IN CONSIDERATION of the mutual entry into this Lease by the parties hereto, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged by each party hereto, the Landlord hereby leases to the Tenant and the Tenant hereby leases from the Landlord all of that real property, situate and lying in Montgomery County, Maryland, which consists of the space (containing approximately 4,169 square feet of floor area) shown outlined in red on a plat attached hereto as Exhibit A (hereinafter referred to as "the Premises") and located in a building (hereinafter referred to as "the Building") at 7503 Standish Place in Rockville, Maryland, on a tract of land designated as "Parcel D" on a plat entitled Gude North, in the Rockville (4th) District of Montgomery County and recorded among the Land Records of the said County in Plat Book 118 at Plat 13906 (the Premises, the remainder of the Building, such tract of land, the three (3) other office buildings thereon, and any other buildings or improvements thereon being hereinafter referred to collectively as "the Property").

SUBJECT TO THE OPERATION AND EFFECT of any and all instruments and matters of record or in fact,

UPON THE TERMS AND SUBJECT TO THE CONDITIONS which are hereinafter set forth:



Section 1. TERM.

1.1 Length. This lease shall be for a term (hereinafter referred to

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as "the Term") (a) commencing on December 20, 1993 day after the date on which the Landlord substantially completes the improvements to be made to the Premises under the provisions of Section 5 and tenders possession thereof to the Tenant (hereinafter referred to as "the Commencement Date", except that if the date of such commencement is hereafter advanced or postponed pursuant to any provision of this Lease, or by written agreement of the parties hereto, the date to which it is advanced or postponed thereafter be "the Commencement Date" for all purposes of the provisions of this Lease), and (b) terminating at 12:01 A.M., local time, on the third (3<sup>rd</sup>/th) anniversary of the first (1<sup>st</sup>) day of the first (1<sup>st</sup>) full calendar month during the Term (hereinafter referred to as "the Termination Date", except that if the date of such termination is hereafter advanced or postponed pursuant to any provision of this Lease, or by written agreement of the parties hereto, the date to which it is advanced or postponed shall thereafter be the Termination Date for all purposes of the provisions of this Lease as applicable thereafter).

1.2 Confirmation of Commencement and Termination. The Tenant shall,

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within thirty (30) days after, respectively, (a) the commencement of the Term, and (b) the expiration of the Term or any earlier termination of this Lease by action of law or in any other manner, confirm in writing that, respectively, such commencement or such termination has occurred, setting forth therein the Commencement Date and the Termination Date.

1.3 Surrender. The Tenant shall at its expense, at the expiration of

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the Term or any earlier termination of this Lease, (a) promptly surrender to the Landlord possession of the Premises (including any fixtures or other improvements which, under the provisions of Section 5, are owned by the Landlord) in good order and repair (ordinary wear and tear accepted) and broom clean, (b) remove therefrom the Tenant's signs, goods and effects and any machinery, trade fixtures and equipment used in conducting the Tenant's trade or business and not owned by the Landlord, and (c) repair any damage to the Premises or the Building caused by such removal.

1.4 Holding Over.

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1.4.1. If the Tenant continues to occupy the Premises after the expiration of the Term or any earlier termination of this Lease after obtaining the Landlord's express, written consent thereto.

(a) such occupancy shall (unless the parties hereto otherwise agree in writing) be deemed to be under a month-to-month tenancy, which shall continue until either party hereto notifies the other in writing, by at least thirty (30) days before the end of any calendar month, that the notifying party elects to terminate such tenancy at the end of such calendar month, in which event such tenancy shall so terminate.

(b) anything contained in the foregoing provisions of this Section to the contrary notwithstanding, the rental payable for each such monthly period shall equal one-twelfth (1/12) of the Base Rent and the Additional Rent payable under the provisions of subsection 2.2 (calculated in accordance with such provisions of subsection 2.2 as if this Lease had been renewed for a period of twelve (12) full calendar months after such expiration or earlier termination of the Term or such renewal); and

(c) such month-to-month tenancy shall be upon the same terms and subject to the same conditions as those set forth in the provisions of this Lease; provided, that if the Landlord gives the Tenant, by at least thirty (30) days before the end of any calendar month during such month-to-month tenancy, written notice that such terms and conditions (including any thereof relating to the amount or payment of Rent) shall, after such month, be modified in any manner specified in such notice, then such tenancy shall, after such month, be upon the said terms and subject to the said conditions, as so modified.

1.4.2. If the Tenant continues to occupy the Premises after the expiration of the Term or any earlier termination of this Lease without obtaining the Landlord's express, written consent thereto, such occupancy shall be on the same terms and subject to the same conditions as those set forth in the provisions of paragraph 1.4.1, except that, anything contained in the provisions of this Lease to the contrary notwithstanding, (a) the rental payable during the period

of such occupancy shall equal one hundred twenty percent (120%) of the rental which would be payable during such period under the provisions of subparagraph 1.4.1.(b), had the Tenant obtained the Landlord's express, written consent to such occupancy, as aforesaid, and (b) nothing in the provisions of paragraph 1.4.1 or any other provision of this Lease shall be deemed in any way to alter or impair the Landlord's right immediately to evict the Tenant or exercise its other rights and remedies under the provisions of this Lease or applicable law on account of the Tenant's occupancy of the Premises without having obtained such consent.

## Section 2. RENT.

2.1 Amount. As rent for the Premises (all of which is hereinafter

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referred to collectively as "Rent"), the Tenant shall pay to the Landlord all of the following:

2.1.1. Base Rent. An annual rent (hereinafter referred to as "the Base Rent") comprised of the aggregate of the following components:

(a) Net Component. A net component (hereinafter referred to as "the Net Component") which

(i) for the first Lease Year during the Term, is in the sum of Thirty-Five Thousand Eight Hundred Fifty-Three and 40/100 Dollars (\$35,853.40) plus (if the Term commences on a day other than the first (1st) day of a calendar month) one three-hundred sixty-fifth (1/365) of the Net Component for each day of such calendar month falling within the Term; and

(ii) for each Lease Year thereafter during the Term, is in a sum equaling the greater of (A) the Net Component for the immediately preceding Lease Year, or (B) the product obtained by multiplying (1) the said sum of Thirty-Five Thousand Eight Hundred Fifty-Three and 40/100 Dollars ( \$35,853.40 ) by (2) a fraction, the numerator of which is the sum of (a) the Initial Consumer Price Index plus (b) 0 % of any excess of the Current Consumer Price Index over the Initial Consumer Price Index, and the denominator of which is the Initial Consumer Price Index. As used herein (a) the term "Consumer Price Index" means the Consumer Price Index for Urban Wage Earners and Clerical Workers Revised (1967 = 100), Washington, D.C., Index, published by the Bureau of Labor Statistics of the United States Department of Labor, (b) the term "Initial Consumer Price Index" means the Consumer Price Index so published for the calendar month containing the Commencement Date, and (c) the term "Current Consumer Price Index" means the Consumer Price Index so published for the calendar month immediately preceding that during which the said Lease Year commences (in each case, if the Consumer Price Index is not so published for such calendar month, then the Consumer Price Index for the most recent calendar month or other period for which it is so published) (provided, that if the Consumer Price Index hereafter uses a different standard reference base or is otherwise revised, an adjustment shall be made therein for purposes of the provisions of this Lease, using such conversion factor, formula or table for making such adjustment as is published by such Bureau, or if such Bureau does not publish the same, then as is published by Prentice-Hall, Inc., the Bureau of National Affairs, Commerce Clearing House or any other nationally recognized publisher of similar statistical information, as selected by the Landlord); and

(b) Costs Component. An initial operating costs component (hereinafter referred to as "the Costs Component") which, for each Lease Year during the Term, is in the sum of Twenty-Two Thousand Nine Hundred Twenty-Nine and 50/100 Dollars ( \$ 22,929.50 ) plus (if the Term commences on a day other than the first (1st) day of a calendar month) for the initial Lease Year, one three-hundred sixty-fifth (1/365) of the Costs Component for each day of such calendar month falling within the Term (but without impairing the Tenant's liability for any Additional Rent accruing under the provisions of subsection 2.2).

2.1.2. Additional Rent. additional rent (hereinafter referred to as "Additional Rent") in the amount of any payment referred to as such in any provision of this Lease which accrues while this Lease is in effect.

2.1.3. Lease Year. As used in the provisions of this Lease, the term "Lease Year" means (a) the period commencing on the Commencement Date and terminating on the

first (1st) anniversary of the last day of the calendar month containing the Commencement Date, and (b) each successive period of twelve (12) calendar months thereafter during the Term.

2.2 Annual Operating Costs.  
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2.2.1. Definitions. As used herein.

(a) the term "Annual Operating Costs" means the actual costs incurred by the Landlord in operating and maintaining the Property during each calendar year of the Term. Such costs shall include, by way of example rather than of limitation, (i) real property front-foot benefit, metropolitan district and other similar taxes or public or private assessments (whether regular or special) levied against any or all of the property; (ii) charges or fees for, and taxes on, the furnishing of water, sewer service, gas, fuel, electricity or other utility services to the Property; (iii) costs of providing elevator, janitorial and trash removal service, and of maintaining grounds, common areas and mechanical systems of buildings; (iv) all other costs of maintaining, repairing or replacing any or all of the Building or the rest of the Property; (v) charges or fees for any necessary governmental permits; (vi) management fees, overhead and expenses; (vii) premiums for hazard, liability, workmens' compensation or similar insurance upon any or all of the Property; (viii) costs arising under service contracts with independent contractors; (ix) costs of any services not provided by the Landlord to the Property on the date hereof but hereafter provided by the Landlord in its prudent management of the Property; and (x) the cost of any other items which, under generally accepted accounting principles consistently applied from year to year with respect to the Property, constitute operating or maintenance costs attributable to any or all of the Property. Such costs shall not include (i) the expense of principal and interest payments made by the Landlord pursuant to the provisions of any mortgage or deed of trust covering the Property; (ii) any deduction for depreciation of the Property taken on the Landlord's income tax returns; or (iii) the cost of capital improvements made to the Property.

(b) The term "Tenant's Operating Costs Percentage" (i) means the percentage assigned to the Premises for purposes of allocating the Annual Operating Costs to the Premises (and the rest of the net rentable spaces within the Property) in accordance with the provisions of this subsection, (ii) represents the approximate and (for purposes of the provisions of this Lease) hereby agreed upon proportion which the floor area of the Premises bears to the aggregate net rentable space within the Property, and (iii) shall be two point five (2.5 %).

2.2.2. Portion covered by Costs Component. The Costs Component of the Base Rent represents the Landlord's estimate on the date hereof of the cost to the Landlord per calendar year of providing to or for the benefit of the Premises all of the services or other items, the costs of which are included in the Annual Operating Costs, excluding any of such services or other items to be provided at the Tenant's direct expense under the provisions of Section 6.

2.2.3. Computation. After the end of each calendar year during the Term, the Landlord shall compute the total of the Annual Operating Costs incurred for all of the Property during such calendar year, and shall allocate them to the net rentable space within the Property in proportion to the respective Operating Costs Percentages assigned to such spaces; provided, that anything contained in the foregoing provisions of this subsection 2.2 to the contrary notwithstanding, wherever the Tenant and/or any other tenant of space within the Property has agreed in its lease or otherwise to provide any item of such services partially or entirely at its own expense, or wherever in the Landlord's judgment any such significant item of expense is not incurred with respect to or for the benefit of all of the net rentable space within the Property, in allocating the Annual Operating Costs pursuant to the foregoing provisions of this subsection the Landlord shall make an appropriate adjustment, using generally accepted accounting principles, as aforesaid, so as to avoid allocating to the Tenant or to such other tenant (as the case may be) those Annual Operating Costs covering such services already being provided by the Tenant or by such other tenant at its own expense, or to avoid allocating to all of the net rentable space within the Property those Annual Operating Costs incurred only with respect to a portion thereof, as aforesaid.

2.2.4. Payments as Additional Rent. The Tenant shall, within thirty (30) days after demand therefor by the Landlord (with respect to each calendar year during the Term), accompanied by a statement setting forth in reasonable detail the Annual Operating Costs for such calendar year, pay to the Landlord as Additional Rent the amount by which (a) the Tenant's

Operating Costs Percentage of the Annual Operating Costs for such calendar year (as derived and allocated under the provisions of paragraph 2.2.3) exceeds (b) the amount of the Costs Component of the Base Rent.

2.2.5. Proration. If only part of any calendar year falls within the Term, the amount computed as Additional Rent for such calendar year under the foregoing provisions of this subsection shall be prorated in proportion to the portion of such calendar year falling within the Term (but the expiration of the Term before the end of a calendar year shall not impair the Tenant's obligation hereunder to pay such prorated portion of such Additional Rent for that portion of such calendar year falling within the Term, which shall be paid on demand, as aforesaid).

2.2.6. Landlord's Right to Estimate. Anything contained in the foregoing provisions of this subsection to the contrary notwithstanding, the Landlord may, at its discretion, (a) make from time to time during the Term a reasonable estimate of the Additional Rent which may become due under such provisions for any calendar year, (b) require the Tenant to pay to the Landlord for each calendar month during such year one twelfth (1/12) of such Additional Rent, at the time and in the manner that the Tenant is required hereunder to pay the monthly installment of the Base Rent for such month, and (c) at the Landlord's reasonable discretion, increase or decrease from time to time during such calendar year the amount initially so estimated for such calendar year, all by giving the Tenant written notice thereof, accompanied by a schedule setting forth in reasonable detail the expenses comprising the Annual Operating Costs, as so estimated. In such event, the Landlord shall cause the actual amount of such Additional Rent to be computed and certified to the Tenant within 120 days after the end of such calendar year, and the Tenant or the Landlord, as the case may be, shall promptly thereafter pay to the other the amount of any deficiency or overpayment therein, as the case may be.

2.3 When Due and Payable.  
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2.3.1. The Base Rent for any Lease Year shall be due and payable in twelve (12) consecutive, equal monthly installments, in advance, on the first (1st) day of each calendar month during such Lease Year; provided, that the installment of the Base Rent payable for the first full calendar month of the Term (and, if the Term commences on a day other than the first (1st) day of a calendar month, that portion of the Base Rent which is payable for such month) shall be due and payable on the Commencement Date.

2.3.2. Any Additional Rent accruing to the Landlord under any provision of this Lease shall, except as is otherwise set forth herein, be due and payable when the installment of the Base Rent next falling due after such Additional Rent accrues becomes due and payable, unless the Landlord makes written demand upon the Tenant for payment thereof at any earlier time, in which event such Additional Rent shall be due and payable at such time.

2.3.3. Each such payment shall be made promptly when due, without any deduction or setoff whatsoever, and without demand, failing which the Tenant shall pay to the Landlord as Additional Rent, for each day on which such payment is due but unpaid, a late charge equaling 1/365th of twenty percent (20%) of such payment.

2.4 Where Payable. The Tenant shall pay the Rent, in lawful currency  
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of the United States of America, to the Landlord by delivering or mailing it (postage prepaid) to the Landlord's address which is set forth hereinabove, or to such other address or in such other manner as the Landlord from time to time specifies by written notice to the Tenant. Any payment made by the Tenant to the Landlord on account of Rent may be credited by the Landlord to the payment of any Rent then past due before being credited to Rent currently falling due. Any such payment which is less than the amount of Rent then due shall constitute a payment made on account thereof, the parties hereto hereby agreeing that the Landlord's acceptance of such payment (whether or not with or accompanied by an endorsement or statement that such lesser amount or the Landlord's acceptance thereof constitutes payment in full of the amount of Rent then due) shall not alter or impair the Landlord's rights hereunder to be paid all of such amount then due, or in any other respect.

2.5. Tax on Lease. If federal, state or local law now or hereafter

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imposes any tax, assessment, levy or other charge (other than any income, inheritance or estate tax) directly or indirectly upon (a) the Landlord with respect to this Lease or the value thereof, (b) the Tenant's use or occupancy of the Premises, (c) the Base Rent, Additional Rent or any other sum payable under this Lease, or (d) this transaction, then (except if and to the extent that such tax, assessment, levy or other charge is included in the Annual Operating Costs) the Tenant shall pay the amount thereof as Additional Rent to the Landlord upon demand, unless the Tenant is prohibited by law from doing so, in which event the Landlord may, at its election, terminate this Lease by giving written notice thereof to the Tenant.

2.6. Security Deposit.

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2.6.1. Simultaneously with the entry into this Lease by the parties hereto, the Tenant shall deposit with the Landlord the sum of Four Thousand eight Hundred Ninety-Nine and 00/100 Dollars (\$4,899.00), which shall be retained by the Landlord as security for the Tenant's payment of the Rent and performance of all of its other obligations under the provisions of this Lease.

2.6.2. On the occurrence of an Event of Default, the Landlord shall be entitled, at its sole discretion,

(a) to apply any or all of such sum in payment of (i) any Rent then due and unpaid, (ii) any expense incurred by the Landlord in curing any such default, and/or (iii) any damages incurred by the Landlord by reason of such default (including, by way of example rather than of limitation, that of reasonable attorneys' fees); and/or

(b) to retain any or all of such sum in liquidation of any or all damages suffered by the Landlord by reason of such default.

2.6.3. On the termination of this Lease, any of such sum which is not so applied or retained shall be returned to the Tenant within 30 days of the Termination date.

2.6.4. Such sum shall not bear interest while being held by the Landlord hereunder.

2.6.5. No Mortgagee (as that term is defined by the provisions of Section 12) or purchaser of any or all of the Property at any foreclosure proceeding brought under the provisions of any Mortgage (as that term is defined by the provisions of Section 12) shall (regardless of whether the Lease is at the time in question subordinate to the lien of any Mortgage under the provisions of Section 12 or otherwise) be liable to the Tenant or any other person for any or all of such sum (or any other or additional security deposit or other payment made by the Tenant under the provisions of this Lease), unless both (a) the Landlord has actually delivered it in cash to such Mortgagee or purchaser, as the case may be, and (b) it has been specifically identified, and accepted by the Lender or such purchaser, as the case may be, as such and for such purpose.

Section 3. USE OF PREMISES.

3.1 The Tenant shall continuously throughout the Term, occupy and use the Premises for and only for general office purposes.

3.2. In its use of the Premises and the remainder of the Property, the Tenant shall not violate any applicable law, ordinance or regulation.

3.3 License.

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3.3.1. The Landlord hereby grants to the Tenant a non-exclusive license to use (and to permit its officers, directors, agents, employees and invitees to use in the course of conducting business at the Premises).

(a) any and all elevators, common stairways, lobbies, common hallways and other portions of the Building which, by their nature, are manifestly designed and intended

for common use by the occupants of the Building for pedestrian ingress and egress to and from the Premises and for any other such manifest purposes; and

(b) any and all portions of the said tract of land on which the Building is located (excluding that portion thereof which is improved by any other building) which, by their nature, are manifestly designed and intended for common use by the occupants of the Building and of any other improvements on such tract, for pedestrian ingress and egress to and from the Premises and for any other such manifest purposes; and

(c) any and all portions of such tract of land as from time to time are designated (by striping or otherwise) by the Landlord for such purpose, for the parking of automobiles.

3.3.2. Such license shall be exercised in common with the exercise thereof by the Landlord, any tenant or owner of the Building or any other building located on such tract, and their respective officers, directors, agents, employees and invitees, and in accordance with the Rules and Regulations promulgated from time to time pursuant to the provisions of Section 11.

3.4. Signs. The Tenant shall have the right to erect from time to time -----  
within the Premises such signs as it desires in accordance with applicable law, except that the Tenant shall not erect any sign within the Premises in any place where such sign is visible primarily from the exterior of the Premises, unless the Landlord has given its express written consent thereto.

3.5. Relocation of Tenant. The Landlord shall have the right one time -----  
during the Term, at the Landlord's expense, to relocate the Premises from their present location within the Building to another location with the Building having at least the same floor area as that of the Premises as shown on Exhibit A, provided that the Landlord gives the Tenant written notice of the Landlord's intention to do so at least thirty (30) days before undertaking such relocation. The Landlord shall, in such event, at the Landlord's expense, install within the Premises as so relocated improvements of the same quality and quantity as those theretofore made by the Tenant or the Landlord to the Premises before such relocation, and on the completion of such installation shall cause the Tenant's machinery, furniture, fixtures and equipment within the Premises to be moved to the Premises as so relocated. Upon the completion of such relocation, this Lease shall automatically thereafter cover the space to which the Premises have been relocated, as aforesaid, all on the same terms and subject to the same conditions as those set forth in the provisions of this Lease as in effect immediately before each relocation, and all without the necessity of further action by either party hereto; provided, that each party hereto shall promptly upon its receipt of a written request therefor from the other, enter into such amendment of this Lease as the requesting party considers reasonably necessary to confirm such relocation.

Section 4. INSURANCE AND INDEMNIFICATION.

4.1. Increase in Risk. The Tenant -----

4.1.1. shall not do or permit to be done any act or thing as a result of which either (a) any policy of insurance of any kind covering (I) any or all of the Property or (ii) any liability of the Landlord in connection therewith may become void or suspended, or (b) the insurance risk under any such policy would (in the opinion of the insurer thereunder) be made greater, and

4.1.2. shall pay as Additional Rent the amount of any increase in any premium for such insurance resulting from any breach of such covenant.

4.2. Insurance to be maintained by Tenant. -----

4.2.1. The Tenant shall maintain at its expense, throughout the Term, insurance against loss or liability in connection with bodily injury, death, property damage or destruction, occurring within the Premises or arising out of the use thereof by the Tenant or its agents, employees, officers or invitees, visitors and guests, under one or more policies of general public liability insurance having such limits as to each as are reasonably required by the Landlord from time to time, but in any event of not less than (a) One Million, Five Hundred Thousand Dollars

(\$1,500,000.00) for bodily injury to or death of all persons in any one occurrence, and (c) Five Hundred Thousand Dollars (\$500,000.00) for property damage or destruction during any one occurrence. Each such policy shall (a) name as the insureds thereunder the Landlord and the Tenant (and, at the Landlord's request, any Mortgagee), (b) by its terms, not be cancellable without at least thirty (30) days prior written notice to the Landlord (and, at the Landlord's request, any such Mortgagee), and (c) be issued by an insurer of recognized responsibility licensed to issue such policy in Maryland.

4.2.2. (a) At least five (5) days before the Commencement Date, the Tenant shall deliver to the Landlord an original or a signed duplicate copy of each such policy, and (b) at least thirty (30) days before any such policy expires, the Tenant shall deliver to the Landlord an original or a signed duplicate copy of a replacement policy (herefor; provided, that so long as such insurance is otherwise in accordance with the provisions of this Section, the Tenant may carry any such insurance under a blanket policy covering the Premises for the risks and in the minimum amounts specified in paragraph 4.2.1, in which event the Tenant shall deliver to the Landlord two (2) insurer's certificates therefor in lieu of an original or a copy thereof, as aforesaid.

4.3. Insurance to be maintained by Landlord. The Landlord shall -----  
maintain through the Term all-risk or fire and extended coverage insurance upon the Building, in at least such amounts and having at least such forms of coverage as are required from time to time by the Landlord's lender. The cost of the premiums for such insurance and of each endorsement thereto shall be deemed, for purposes of the provisions of Section 2, to be a cost of operating and maintaining the Property.

4.4. Waiver of Subrogation. If either party hereto is paid any -----  
proceeds under any policy of insurance noting such party as an insured, on account of any loss, damage or liability, then such party hereby releases the other party hereto, to and only to the extent of the amount of such proceeds, from any and all liability for such loss, damage or liability, notwithstanding that such loss, damage or liability may arise out of the negligent or intentionally tortious act or omission of the other party, its agents or employees; provided, that such release shall be effective only as to a loss, damage or liability occurring while the appropriate policy of insurance of the releasing party provides that such release shall not impair the effectiveness of such policy or the insured's ability to recover thereunder. Each party hereto shall use reasonable efforts to have a clause to such effect included in its said policies, and shall promptly notify the other in writing if such clause cannot be included in any such policy.

4.5. Liability of Parties. Except if and to the extent that such -----  
party is released from liability to the other party hereto pursuant to the provisions of subsection 4.4.

4.5.1. the Landlord (a) shall be responsible for, and shall indemnify and hold harmless the Tenant against and from any and all liability arising out of, any injury to or death of any person or damage to any property, occurring anywhere upon the Property, if, only if and to the extent that such injury, death or damage is proximately caused by the negligent or intentionally tortious act or omission of the Landlord or its agents, officers or employees, but (b) shall not be responsible for or be obligated to indemnify or hold harmless the Tenant against or from any liability for any such injury, death or damage occurring anywhere upon the Property (including the Premises), (i) by reason for the Tenant's occupancy or use of the Premises or any other portion of the Property, or (ii) because of fire, windstorm, act of God or other cause unless proximately caused by such negligent or intentionally tortious act or omission of the Landlord, as aforesaid; and

4.5.2. subject to the operation and effect of the foregoing provisions of this subsection, the Tenant shall be responsible for, and shall defend, indemnify and hold harmless the Landlord against and from, any and all liability or claim of liability arising out of any injury to or death of any person or damage to any property, occurring within the Premises.

Section 5. IMPROVEMENTS TO PREMISES.

5.1. By Landlord

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5.1.1. The Landlord shall make the improvements to the Premises which are set forth in the plans and specifications attached hereto as Exhibit B.

5.1.2. See Addendum Paragraph 4.

5.1.3. The Landlord shall use its best efforts to complete such improvements by the date on which the Tenant is entitled to occupy the Premises pursuant to this Lease, but shall have no liability to the Tenant hereunder if prevented from doing so by reason of any (a) strike, lock-out or other labor troubles, (b) governmental restrictions or limitations, (c) failure or shortage of electrical power, gas, water, fuel oil, or other utility or service, (d) riot, war, insurrection or other national or local emergency, (e) accident, flood, fire or other casualty, (f) adverse weather condition, (g) other act of God, (h) inability to obtain a building permit or a certificate of occupancy, or (i) other cause similar or dissimilar to any of the foregoing and beyond the Landlord's reasonable control. In such event, (a) the Commencement Date shall be postponed for a period equalling the length of such delay, (b) the Termination Date shall be determined pursuant to the provisions of subsection 1.1 by reference to the Commencement Date as so postponed, and (c) the Tenant shall accept possession of the Premises within ten (10) days after such completion); provided, that anything contained in the provisions of this Lease to the contrary notwithstanding, if the Landlord does not substantially complete such improvements, obtain a use and occupancy permit therefor, and tender possession thereof to the Tenant, all by March 1, 1994. the Tenant shall be entitled at any time thereafter, and so long as such events have not occurred, to terminate this Lease by giving written notice thereof to the Landlord; and further provided that if the Term has not commenced by April 1, 1994, this Lease shall thereupon automatically terminate. If this Lease is terminated pursuant to the foregoing provisions of this paragraph, neither party automatically terminate. If this Lease is terminated pursuant to the foregoing provisions of this paragraph, neither party hereto shall have any liability hereunder to the other on account thereof (except that the Landlord shall promptly return to the Tenant any money paid by the Tenant to the Landlord pursuant to the provisions of subsections 2.4 or 2.6).

5.2. Acceptance of Possession. Except for (a) latent defects or

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incomplete work which would not reasonably have been revealed by an inspection of the Premises made for the purpose of discovering the same when the Landlord delivers possession of the Premises to the Tenant, and (b) any other item of incomplete work set forth on a "punch list" prepared by the Tenant and approved in writing by the Landlord before such delivery of possession, by its assumption of possession of the Premises the Tenant shall for all purposes of the provisions of this Lease be deemed to have accepted them and to have acknowledged them to be in the condition called for hereunder.

5.3. By Tenant. The Tenant shall not make any alteration, addition or

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improvement to the premises without first obtaining the Landlord's written consent thereto. If the Landlord consents to any such proposed alteration, addition or improvement, it shall be made at the Tenant's sole expense (and the Tenant shall hold the Landlord harmless from any cost incurred on account thereof), and at such time and in such manner as not unreasonably to interfere with the use and enjoyment of the remainder of the Property by any tenant thereof or other person.

5.4. Mechanics' Liens. The Tenant shall (a) immediately after it is

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filed or claimed, bond or have released any mechanics', materialman's or other lien filed or claimed against any or all of the Premises, the Property, or any other property owned or leased by the Landlord, by reason of labor or materials provided for the Tenant or any of its contractors or subcontractors (other than labor or materials provided by the Landlord pursuant to the provisions of subsection 5.1), or otherwise arising out of the Tenant's use or occupancy of the Premises or any other portion of the Property, and (b) defend, indemnify and hold harmless the Landlord against and from any and all liability, claim of liability or expense (including, by way of example rather than of limitation, that of reasonable attorneys' fees) incurred by the Landlord on account of any such lien or claim.

5.5. Fixtures. Any and all improvements, repairs, alterations and all

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other property attached to used in connection with or otherwise installed within the Premises by the Landlord of



the Tenant shall, immediately on the completion of their installation, become the Landlord's property without payment therefor by the Landlord, except that any machinery, equipment or fixtures installed by the Tenant and used in the conduct of the Tenant's trade or business (rather than to service the Premises or any of the remainder of the Building or the Property generally) shall remain the Tenant's property.

Section 6. MAINTENANCE AND SERVICES.

6.1. Ordinary Services.  
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6.1.1. The Landlord shall provide the following services to or for the benefit of the Premises: (a) heating and air-conditioning (during those respective seasons of the year in which they are necessary) for the comfortable use and occupancy of the Premises, electricity and water suitable for the use of the Premises in accordance with the provisions of Section 3, and automatic elevator service within the Building, all between 8 o'clock A.M. and 6 o'clock PM, Monday through Friday (except for legal holidays), of each week during the Term; and

(b) janitorial service and trash removal service after 5 o'clock PM, Monday through Friday (except for legal holidays) of each week during the Term.

6.1.2. Such services shall be furnished at the Landlord's expense (subject to the operation and effect of the provisions of subsection 2.2).

6.2. Extraordinary Services.  
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6.2.1. The Landlord shall not be obligated to provide to or for the benefit of the Premises any of the services referred to in the provisions of subsection 6.1 other than during the hours referred to therein. If the Landlord elects in its sole discretion to provide such services other than during such hours, and if the Tenant utilizes any of them, the Tenant shall pay to the Landlord as Additional Rent the amount from time to time charged by the Landlord therefor, as set forth on the written schedule of such charges most recently provided by the Landlord to the Tenant.

6.2.2. The Tenant shall not, without first obtaining the Landlord's written consent thereto, install within the Premises any electrical machinery, appliances or equipment (including, by way of example rather than of limitation, any electrical heating, cooking, water-heating or refrigeration equipment, kitchen equipment, photocopying equipment, electronic data processing machinery, reproduction equipment or punch-card machinery) which either (a) uses electrical current in excess of 10 amperes at 110 volts or (b) in any way increases the amount of electricity consumed upon the Premises beyond those wattages specified herein below, and shall pay periodically as Additional Rent the additional expense incurred by the Landlord as a result thereof, including that resulting from any installation of such equipment. Without limiting the generality of the foregoing provisions of this paragraph, the Landlord shall have the right from time to time, using established calculation methods and/or one or more temporary or permanent sub-meters or other devices to measure the consumption of electricity upon the Premises. The cost of such calculations and/or measuring shall be borne by the Landlord unless such measuring indicates that the electricity being consumed upon the Premises exceeds (a) for lighting, two (2) watts per square foot of floor area within the Premises, or (b) for other electrical consumption, one (1) watt per square foot of floor area within the Premises, in which event the Tenant shall reimburse the Landlord for the cost of such calculations and/or measuring, and shall in addition pay to the Landlord monthly, as Additional Rent, the cost incurred by the Landlord thereafter in furnishing such additional electricity to the Premises, which cost shall be estimated on a monthly basis by the Landlord using its reasonable discretion, and shall be adjusted at the end of each calendar year to reflect the actual cost of such excess electricity incurred by the Landlord during such calendar year.

6.3. Interruption. The Landlord shall have no liability to the Tenant  
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on account of any failure, modification or interruption of any such service which either (a) arises out of any of the causes enumerated in the provisions of subsection 5.1, or (b) is required by applicable law

(including, by way of example rather than of limitation, any federal law or regulation relating to the furnishing or consumption of energy or the temperature of buildings).

6.4. Maintenance by Tenant. The Tenant shall maintain the -----  
nonstructural parts of the interior of the Premises in good repair and condition, ordinary wear and tear accepted.

6.5. Maintenance by Landlord. The Landlord shall furnish, supply and -----  
maintain in good order and repair (a) the roof, structure and remainder of the exterior of the Building, (b) any and all hallways, stairways, lobbies, elevators, heating and air-conditioning facilities, electrical, sanitary sewer and water lines and facilities, restroom facilities, grounds, sidewalks and parking areas (including the removal of snow from such sidewalks and parking areas), and other common areas, all if located within the Building or the rest of the Property but not within the Premises except for restroom and kitchen facilities excluding Tenant provided kitchen appliances, all at the Landlord's expense except as is set forth in the provisions of Section 2 or any other provision of this Lease.

Section 7. LANDLORD'S RIGHT OF ENTRY.

The Landlord and its agents shall be entitled to enter the Premises at any reasonable time (a) to inspect the Premises, (b) to exhibit the Premises to any existing or prospective purchaser, Tenant or Mortgagee thereof, (c) to make any alteration, improvement or repair to the Building or the Premises, or (d) for any other purpose relating to the operation of maintenance of the Property; provided, that the Landlord shall (a) unless doing so is impractical or unreasonable because of emergency) give the Tenant at least twenty-four (24) hours prior notice of its intention to enter the Premises, and (b) use reasonable efforts to avoid thereby interfering more than is reasonably necessary with the Tenant's use and enjoyment thereof.

Section 8. FIRE AND OTHER CASUALTIES.

8.1. General. If the Premises are damaged by fire or other casualty -----  
during the Term,

8.1.1. the Landlord shall restore the Premises with reasonable promptness (taking into account the time required by the Landlord to effect a settlement with, and to procure any insurance proceeds from, any insurer against such casualty, but in any event within one hundred fifty (150) days after the date of such casualty) to substantially their condition immediately before such casualty, and may temporarily enter and possess any or all of the Premises for such purpose (provided, that the Landlord shall not be obligated to repair, restore or replace any fixture, improvement, alteration, furniture or other property owned, installed or made by the Tenant), but

8.1.2. the times for commencement and completion of any such restoration shall be extended for the period (not longer than sixty (60) days) of any delay occasioned by the Landlord in doing so arising out of any of the causes enumerated in the provisions of subsection 5.1. If the Landlord undertakes to restore the Premises and such restoration is not accomplished within the said period of one hundred fifty (150) days plus the period of any extension thereof, as aforesaid, the Tenant may terminate this Lease by giving written notice thereof to the Landlord within thirty (30) days after the expiration of such period, as so extended; and

8.1.3. so long as the Tenant is deprived of the use of any or all of the Premises on account of such casualty, the Base Rent and any Additional Rent payable under the provisions of subsection 2.2 shall be abated in proportion to the number of square feet of the Premises rendered substantially unfit for occupancy by such casualty, unless, because of any such damage, the undamaged portion of the Premises is made materially unsuitable for use by the Tenant for the purposes set forth in the provisions of Section 3, in which event the Base Rent and any such Additional Rent shall be abated entirely during such period of deprivation.

8.2 Substantial Destruction. Anything contained in the foregoing

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provisions of this Section to the contrary notwithstanding.

8.2.1. if during the Term the Building is so damaged by fire or other casualty that (a) either the Premises or (whether or not the Premises are damaged) the Building is rendered substantially unfit for occupancy, as reasonably determined by the Landlord, or (b) the Building is damaged to the extent that the Landlord reasonably elects to demolish the Building, or if any Mortgage requires that any or all of such insurance proceeds be used to retire any or all of the debt secured by its Mortgage, then in any such case the Landlord may elect to terminate this Lease as of the date of such casualty, by giving written notice thereof to the Tenant within thirty (30) days after such date; and

8.2.2. in such event, (a) the Tenant shall pay to the Landlord the Base Rent and any Additional Rent payable by the Tenant hereunder and accrued through the date of such termination, (b) the Landlord shall repay to the Tenant any and all prepaid Rent for periods beyond such termination, and (c) the Landlord may enter upon and repossess the Premises without further notice.

8.3. Tenant's Negligence. Anything contained in any provision of this

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Lease to the contrary notwithstanding, if any such damage to the Premises, the Building or both are caused by or result from the negligent or intentionally tortious act or omission of the Tenant, those claiming under the Tenant or any of their respective officers, employees, agents or invitees.

8.3.1. the Rent shall not be suspended or apportioned as aforesaid, and

8.3.2. except if and to the extent that the Tenant is released from liability therefore pursuant to the provisions of subsection 4.4. the Tenant shall pay to the Landlord upon demand, as Additional Rent, the cost of (a) any repairs and restoration made or to be made as a result of such damage, or (b) (if the Landlord elects not to restore the Building) any damage or loss which the Landlord incurs as a result of such damage.

Section 9. CONDEMNATION.

9.1. Rights to Award.

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9.1.1. If any or all of the Premises are taken by the exercise of any power of eminent domain or are conveyed to or at the direction of any governmental entity under a threat of any such taking (each of which is hereinafter referred to as a "Condemnation"), the Landlord shall be entitled to collect from the condemning authority thereunder the entire amount of any award made in any such proceeding or as consideration for such conveyance, without deduction therefrom for any leasehold or other estate held by the Tenant under this Lease.

9.1.2. The Tenant hereby (a) assigns to the Landlord all of the Tenant's right, title and interest, if any, in and to any such award; (b) waives any right which it may otherwise have in connection with such Condemnation, against the Landlord or such condemning authority, to any payment for (i) the value of the then unexpired portion of the Term, (ii) leasehold damages, and (iii) any damage to or diminution of the value of the Tenant's leasehold interest hereunder or any portion of the Premises not covered by such Condemnation; and (c) agrees to execute any and all further documents which may be required to facilitate the Landlord's collection of any and all such awards.

9.1.3. Subject to the operation and effect of the foregoing provisions of this Section, the Tenant may seek, in a separate proceeding, a separate award on account of any damages or costs incurred by the Tenant as a result of such Condemnation, so long as such separate award in no way diminishes any award or payment which the Landlord would otherwise receive as a result of such Condemnation.

9.2. Effect of Condemnation.

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9.2.1. If (a) all of the Premises are covered by a Condemnation, or (b) any part of the Premises is covered by a Condemnation and the remainder thereof is insufficient for the reasonable operation therein of the Tenant's business, or (c) any of the Building is covered by a Condemnation and, in the Landlord's reasonable opinion, it would be impractical to restore the remainder thereof, or (d) any of the rest of the Property is covered by a Condemnation and, in the Landlord's reasonable opinion, it would be impractical to continue to operate the remainder of the Property thereafter, then, in any such event, the Term shall terminate on the date on which possession of so much of the Premises, the Building or the rest of the Property, as the case may be, as is covered by such Condemnation is taken by the condemning authority thereunder, and all Rent (including, by way of example rather than of limitation, any Additional Rent payable under the provisions of subsection 2.2), taxes and other charges payable hereunder shall be apportioned and paid to such date.

9.2.2. If there is a Condemnation and the Term does not terminate pursuant to the foregoing provisions of this subsection, the operation and effect of this Lease shall be unaffected by such Condemnation, except that the Base Rent shall be reduced in proportion to the square footage of floor area, if any, of the Premises covered by such Condemnation.

9.3. If there is a Condemnation, the Landlord shall have no liability to the Tenant on account of any (a) interruption of the Tenant's business upon the Premises, (b) diminution in the Tenant's ability to use the Premises, or (c) other injury or damage sustained by the Tenant as a result of such Condemnation.

9.4. Except for any separate proceeding brought by the Tenant under the provisions of paragraph 9.1.3, the Landlord shall be entitled to conduct any such condemnation proceeding and any settlement thereof free of interference from the Tenant, and the Tenant hereby waives any right which it otherwise has to participate therein.

#### Section 10. ASSIGNMENT AND SUBLETTING.

10.1 The Tenant hereby acknowledges that the Landlord has entered into this Lease because of the Tenant's financial strength, good will, ability and expertise and that, accordingly, this Lease is one which is personal to the Tenant, and agrees for itself and its successors and assigns in interest hereunder that it will not (a) assign any of its rights under this Lease, or (b) make or permit any total or partial sale, lease, sublease, assignment, conveyance, license, mortgage, pledge, encumbrance or other transfer of any or all of the Premises or the occupancy or use thereof (each of which is hereinafter referred to as a "Transfer"), without first obtaining the Landlord's written consent thereto (which consent may be given or withheld in the Landlord's sole discretion and, if given, shall not constitute a consent to any subsequent such Transfer, whether by the person hereinabove named as "the Tenant" or by any such transferee). The Landlord shall be entitled, at its sole discretion, to condition any such consent upon the entry by such person into an agreement with (and in form and substance satisfactory to) the Landlord, by which it assumes all of the Tenant's obligations hereunder. Any person to whom any Transfer is attempted without such consent shall have no claim, right or remedy whatsoever hereunder against the Landlord, and the Landlord shall have no duty to recognize any person claiming under or through the same. No such action taken with or without the Landlord's consent shall in any way relieve or release the Tenant from Liability for the timely performances of all of the Tenant's obligations hereunder.

10.2. Anything contained in the foregoing provisions of this Section to the contrary notwithstanding, neither the Tenant nor any other person having an interest in the possession, use or occupancy of the Premises or any other portion of the Property shall enter into any lease, sublease, license, concession or other agreement for the possession, use or occupancy of space in the Premises or any other portion of the Property which provides for any rental or other payment for such use, occupancy or utilization based in whole or in part upon the net income or profits derived by any person from the space in the Premises or other portion of the Property so leased, used or occupied (other than any amount based on a fixed percentage or percentages of receipts or sales).

Section 11. RULES AND REGULATIONS.

The Landlord shall have the right to prescribe, at its sole discretion, reasonable rules and regulations (hereinafter referred to as "the Rules and Regulations") having uniform applicability to all tenants of the Building (subject to the provisions of their respective leases) and governing their use and enjoyment of the Building and the remainder of the Property; provided, that the Rules and Regulations shall not materially interfere with the Tenant's use and enjoyment of the Premises, in accordance with the provisions of this Lease, for the purpose enumerated in the provisions of Section 3. The Tenant shall adhere to the Rules and Regulations and shall cause its agents, employees, invitees, visitors and guests to do so. A copy of the Rules and Regulations in effect on the date hereof is attached hereto as Exhibit C.

Section 12. SUBORDINATION; ATTORNMENT AND NON-DISTURBANCE.

12.1. Subordination. This Lease shall be subject and subordinate to the

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lien, operation and effect of each first mortgage, first deed of trust, ground lease and/or other, similar instrument of encumbrance heretofore or hereafter covering any or all of the Premises or the remainder of the Property (and each renewal, modification, consolidation, replacement or extension thereof), (each of which is herein referred to as a "Mortgage"), all automatically and without the necessity of any action by either party hereto.

12.2. Attornment and Non-disturbance. The Tenant shall, promptly at

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the request of the Landlord or the holder of any first Mortgage (herein referred to as "Mortgagee"), execute, enseal, acknowledge and deliver such further instrument or instruments

12.2.1. evidencing such subordination as the Landlord or such Mortgagee deems necessary or desirable, and

12.2.2. (at such Mortgagee's request) attorning to such Mortgagee, provided that such Mortgagee agrees with the Tenant that such Mortgagee will, in the event of a foreclosure of any such mortgage or deed of trust (or termination of any such ground lease) take no action to interfere with the Tenant's rights hereunder, except on the occurrence of an Event of Default.

12.3. Anything contained in the provisions of this Section to the contrary notwithstanding, any Mortgagee may at any time subordinate the lien of its Mortgage to the operation and effect of this Lease without obtaining the Tenant's consent thereto, by giving the Tenant written notice thereof, in which event this Lease shall be deemed to be senior to such Mortgage without regard to their respective date of execution, delivery and/or recordation among the Land Records of the said County, and thereafter such Mortgagee shall have the same rights as to this Lease as it would have had, were this Lease executed and delivered before the execution of such Mortgage.

Section 13. DEFAULT.

13.1. Definition: As used in the provisions of this Lease, each of the

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following events shall constitute, and is hereinafter referred to as, an "Event of Default".

13.1.1. If the Tenant fails to (a) pay any Rent or any other sum which it is obligated to pay by any provision of this Lease, when and as due and payable hereunder and without demand therefor, or (b) perform any of its other obligations under the provisions of this Lease; or

13.1.2. if the Tenant (a) applies for or consents to the appointment of a receiver, trustee or liquidator of the Tenant or of all or a substantial part of its assets, (b) files a voluntary petition in bankruptcy or admits in writing its inability to pay its debts as they come due, (c) makes an assignment for the benefit of its creditors, (d) files a petition or an answer seeking a reorganization or an arrangement with creditors, or seeks to take advantage of any insolvency

law, (e) performs any other act of bankruptcy, or (f) files an answer admitting the material allegations of a petition filed against the Tenant in any bankruptcy, reorganization or insolvency proceeding; or

13.1.3. if (a) an order, judgment or decree is entered by any court of competent jurisdiction adjudicating the Tenant a bankrupt or an insolvent, approving a petition seeking such a reorganization, or appointing a receiver, trustee or liquidator of the Tenant or of all or a substantial part of its assets, or (b) there otherwise commences as to the Tenant or any of its assets any proceeding under any bankruptcy, reorganization, arrangement, insolvency, readjustment, receivership or similar law, and if such order, judgment, decree or proceeding continues unstayed for more than sixty (60) consecutive days after any stay thereof expires; or

13.1.4. if the Tenant fails to occupy and assume possession of the Premises within fifteen (15) days after the Commencement Date.

13.2. Notice to Tenant; Grace Period. Anything contained in the

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provisions of this Section to the contrary notwithstanding, on the occurrence of an Event of Default the Landlord shall not exercise any right or remedy which it holds under any provision of this Lease or applicable law unless and until

13.2.1. the Landlord has given written notice thereof to the Tenant, and

13.2.2. the Tenant has failed, (a) if such Event of Default consists of a failure to pay money, within five (5) days thereafter to pay all of such money, or (b) if such Event of Default consists of something other than a failure to pay money, within thirty (30) days thereafter actively, diligently and in good faith to begin to cure such Event of Default and to continue thereafter to do until it is fully cured; provided, that

13.2.3. no such notice shall be required, and the Tenant shall be entitled to no such grace period, (a) in any emergency situation in which the Landlord acts to cure such Event of Default pursuant to the provisions of paragraph 13.3.5; or (b) more than twice during any twelve (12) month period, or (c) if the Tenant has substantially terminated or is in the process of substantially terminating its continuous occupancy and use of the Premises for the purpose set forth in the provisions of Section 3, or (d) in the case of any Event of Default enumerated in the provisions of paragraphs 13.1.2. or 13.1.3.

13.3. Landlord's Rights on Event of Default. On the occurrence of any

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Event of Default, the Landlord may (subject to the operation and effect of the provisions of subsection 13.2) take any or all of the following actions:

13.3.1. re-enter and repossess the Premises and any and all improvements thereon and additions thereto provided such entrance is in a manner consistent with applicable law.

13.3.2. declare the entire balance of the Rent for the remainder of the Term to be due and payable, and collect such balance plus reasonable costs of reletting the Premises and minus the rental income occurring during the Tenant's lease term that Landlord reasonably expects to achieve by reletting the Premises in any manner not inconsistent with applicable law;

13.3.3. terminate this Lease;

13.3.4. relet any or all of the Premises for the Tenant's account for any or all of the remainder of the Term as hereinabove defined, or for a period exceeding such remainder, in which event the Tenant shall pay to the Landlord, at the times and in the manner specified by the provisions of Section 2, the Base Rent and any Additional Rent accruing during such remainder, less any monies received by the Landlord, with respect to such remainder, from such reletting, as well as the cost to the Landlord of any attorneys' fees or of any repairs or other action (including those taken in exercising the Landlord's rights under any provision of this Lease) taken by the Landlord on account of such Event of Default;

13.3.5. cure such Event of Default in any other manner (after giving the Tenant written notice of the Landlord's intention to do so except as provided in paragraph 13.2.3), in which event the Tenant shall reimburse the Landlord for all expenses incurred by the Landlord in doing so, plus interest thereon at a lesser of the rate of twenty percent (20%) per annum or the highest rate then permitted on account thereof by applicable law, which expenses and interest shall be Additional Rent and shall be payable by the Tenant immediately on demand therefor by the Landlord and/or

13.3.6. pursue any combination of such remedies and/or any other remedy available to the Landlord on account of such Event of Default under applicable law.

13.5. No Waiver. No action taken by the Landlord under the provisions

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of this Section shall operate as a waiver of any right which the Landlord would otherwise have against the Tenant for the Rent hereby reserved or otherwise, and the Tenant shall remain responsible to the Landlord for any loss and/or damage suffered by the Landlord by reason of any Event of Default.

13.6. Default by Landlord. If the Landlord violates any of its

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obligations under the provisions of this Lease, the Tenant may (subject to the operation and effect of the provisions of paragraph 2.3.3) exercise any right or remedy which it holds on account thereof hereunder, at law or in equity; provided, that if any or all of the Premises is then subject to any first Mortgage, the Tenant shall not exercise any of its rights or remedies on account thereof unless and until it has given written notice of its intention to do so, by certified or registered mail, return receipt requested, to the Mortgagee under such first Mortgage, specifying therein the nature of such default in reasonable detail, and unless such Mortgagee has not cured such default on the Landlord's behalf within thirty (30) days after such notice is given.

Section 14. ESTOPPEL CERTIFICATE.

The Tenant shall from time to time, within five (5) days after being requested to do so by the Landlord or any Mortgagee, execute, enseal, acknowledge and deliver to the Landlord (or, at the Landlord's request, to any existing or prospective purchaser, transferee, assignee or Mortgagee of any or all of the Premises, the Property, any interest therein or any of the Landlord's rights under this Lease) an instrument in recordable form,

14.1. certifying (a) that this Lease is unmodified and in full force and effect (or, if there has been any modification thereof, that it is in full force and effect as so modified, stating therein the nature of such modification); (b) as to the dates to which the Base Rent and any Additional Rent and other charges arising hereunder have been paid; (c) as to the amount of any prepaid Rent or any credit due to the Tenant hereunder; (d) that the Tenant has accepted possession of the Premises, and the date on which the Term commenced; (e) as to whether, to the best knowledge, information and belief of the signer of such certificate, the Landlord or the Tenant is then in default in performing any of its obligations hereunder (and, if so, specifying the nature of each such default); and (f) as to any other fact or condition reasonably requested by the Landlord or such other addressee; and

14.2. acknowledging and agreeing that any statement contained in such certificate may be relied upon by the Landlord and any such other addressee.

Section 15. QUIET ENJOYMENT.

The Landlord hereby covenants that the Tenant, on paying the Rent and performing the covenants set forth herein, shall peaceably and quietly hold and enjoy, throughout the Term, (a) the Premises, and (b) such rights as the Tenant may hold hereunder with respect to the remainder of the Property.

Section 16. NOTICES.

Any notice, demand, consent, approval, request or other communication or document to be provided hereunder to a party hereto shall be (a) given in writing, and (b) deemed to have been given (i) forty-eight (48) hours after being sent as certified or registered mail in the United States mails, postage prepaid, return receipt requested, to the address of such party set forth hereinabove or to such other address in the United States of America as such party may designate from time to time by notice to the other, or (ii) (if such party's receipt thereof is acknowledged in writing) upon its hand or other delivery to such party.

Section 17. GENERAL.

17.1. Effectiveness. This Lease shall become effective upon and only upon its execution and delivery by each party hereto.

17.2. Complete Understanding. This Lease represents the complete understanding between the parties hereto as to the subject matter hereof, and supersedes all prior written or oral negotiations, representations, warranties, statements or agreements between the parties hereto as to the same.

17.3. Amendment. This Lease may be amended by and only by an instrument executed and delivered by each party hereto.

17.4. Applicable Law. This Lease shall be given effect and construed by application of the law of Maryland, and any action or proceeding arising hereunder shall be brought in the courts of Maryland; provided, that if such action or proceeding arises under the Constitution, laws or treaties of the United States of America, or if there is a diversity of citizenship between the parties thereto, so that it is to be brought in a United States District Court, it shall be brought in the United States District Court for the District of Maryland.

17.5. Waiver. The Landlord shall not be deemed to have waived the exercise of any right which it holds hereunder unless such waiver is made expressly and in writing (and no delay or omission by the Landlord in exercising any such right shall be deemed to be a waiver of its future exercise). No such waiver as to any instance involving the exercise of any such right shall be deemed a waiver as to any other such instance, or any other such right.

17.6. Time of Essence. Time shall be of the essence of this Lease.

17.7. Headings. The headings of the Sections, subsections, paragraphs and subparagraphs hereof are provided herein for and only for convenience of reference, and shall not be considered in construing their contents.

17.8. Construction. As used herein,

17.8.1. the term "person" means a natural person, a trustee, a corporation, a partnership and any other form of legal entity; and

17.8.2. all references made (a) in the neuter, masculine or feminine gender shall be deemed to have been made in all such genders, (b) in the singular or plural number shall be deemed to have been made, respectively, in the plural or singular number as well, and (c) to any Section, subsection, paragraph or subparagraph shall, unless therein expressly indicated to the contrary, be deemed to have been made to such Section, subsection, paragraph or subparagraph of this Lease.

17.9. Exhibits. Each writing or plat referred to herein as being attached hereto as an exhibit or otherwise designated herein as an exhibit hereto is hereby made a part hereof.

17.10. Severability. No determination by any court, governmental body or otherwise that any provision of his Lease or any amendment hereof is invalid or unenforceable in any instance shall affect the validity or enforceability of (a) any other such provision, or (b) such



provision in any circumstance not controlled by such determination. Each such provision shall be valid and enforceable to the fullest extent allowed by, and shall be construed wherever possible as being consistent with, applicable law.

17.11. Definition of "the Landlord".  
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17.11.1 As used herein, the term "the Landlord" means the person hereinabove named as such, and its heirs, personal representatives, successors and assigns (each of whom shall have the same rights, remedies, powers, authorities and privileges as it would have had, had it originally signed this lease as the Landlord).

17.11.2. No person holding the Landlord's interest hereunder (whether or not such person is named as "the Landlord" herein) shall have any liability hereunder after such person ceases to hold such interest, except for any such liability accruing while such person holds such interest.

17.11.3. Neither the Landlord nor any principal of the Landlord, whether disclosed or undisclosed, shall have any personal liability under any provision of this Lease. If the Landlord defaults in performing any of its obligations hereunder or otherwise, the Tenant shall look solely to the Landlord's equity, interest and rights in the Property to satisfy the Tenant's remedies on account thereof.

17.12. Definition of "the Tenant". As used herein, the term "the Tenant"  
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means each person hereinabove named as such and such person's heirs, personal representatives, successors and assigns, each of whom shall have the same obligations, liabilities, rights and privileges as it would have possessed had it originally executed this Lease as the Tenant; provided, that no such right or privilege shall inure to the benefit of any assignee of the Tenant, immediate or remote, unless the assignment to such assignee is made in accordance with the provisions of Section 10. Whenever two or more persons constitute the Tenant, all such persons shall be jointly and severally liable for performing the Tenant's obligations hereunder.

17.13. Commissions. Each party hereto hereby represents and warrants to  
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the other that, in connection with the leasing of the Premises hereunder, the party so representing and warranting has not dealt with any real estate broker, agent or finder, and there is no commission, charge or other compensation due on account thereof. Each party hereto shall indemnify and hold harmless the other against and from any inaccuracy in such party's representation except McShea and Co.

17.14. Recordation. This Lease may not be recorded among the Land  
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Records of the said County or among any other public records, without the Landlord's prior express, written consent thereto, and any attempt by the Tenant to do so without having obtained the Landlord's consent thereto shall constitute an Event of Default hereunder. If this Lease is recorded by either party hereto, such party shall bear the full expense of any transfer, documentary stamp or other tax, and any recording fee, assessed in connection with such recordation; provided, that if under applicable Maryland or other law the recordation of this Lease hereafter becomes necessary in order for this Lease to be or remain effective, the Tenant shall bear the full expense of any and all such taxes and fees incurred in connection therewith.

17.15. Approval by Mortgagees. Anything contained in the provisions of  
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this Lease to the contrary notwithstanding, the Landlord shall be entitled at any time hereafter but before the Landlord delivers possession of the Premises to the Tenant hereunder, to terminate this Lease by giving written notice thereof to the Tenant, if any Mortgagee fails to approve this Lease for purposes of the provisions of its Mortgage, and in the manner set forth therein.

IN WITNESS WHEREOF, each party hereto has executed and ensealed this Lease or caused it to be executed and ensealed on its behalf by its duly authorized representatives, the day and year first above written.

WITNESS

ROCKVILLE OFFICE/INDUSTRIAL ASSOCIATES

Not legible

By: /s/ Donald G. Taylor

(SEAL)

The Landlord

WITNESS or ATTEST:

COMTEQ FEDERAL, INC.

/s/ Deborah M. Kearnes

By: /s/ Scott Shulman

(SEAL)

The Tenant

AGREEMENT OF LEASE

by and between

ROCKVILLE OFFICE / INDUSTRIAL ASSOCIATES

and

COMTEQ FEDERAL, INC.

1. Insert the following language at the end of Paragraph 2 of the Lease Agreement:

"Tenant acknowledges that it has inspected and accepts the Premises, and specifically the Building and improvements comprising the same in their present condition as suitable for the purpose for which the Premises are leased. Execution of the Lease by Tenant shall be deemed conclusively to establish that said Building and other improvements are in good and satisfactory condition as of when the execution was made. Tenant further acknowledges that no representations as to the repair of the Premises, nor promises to alter, removal or improve the Premises have been made by Landlord, unless such are expressly set forth in this Lease. If this Lease is executed before the Premises become vacant or otherwise occupant of the Premises holds over, and Landlord cannot acquire possession of the Premises prior to the date above recited as to the Commencement Date of this Lease, Landlord shall not be deemed to be in default hereunder, and Tenant agrees to accept possession which date shall henceforth be deemed the "Commencement Date"; and Landlord hereby waives payment of rent covering any period prior to tendering of possession to Tenant hereunder; and the term shall commence on the new Commencement Date as if it were the original commencement date. If, however, Landlord cannot acquire possession of the Premises and tender possession thereof to the Tenant by March 1, 1994, the Tenant shall be entitled at any time thereafter to Terminate this Lease by giving written notice thereof to the Landlord; and further provided, that if the term has not commenced by April 1, 1994, this Lease shall automatically terminate. If this Lease is terminated pursuant to the foregoing provisions of this paragraph, neither party hereto shall have any liability hereunder to the other on account thereof.

2. Waiver of Trail by Jury. Landlord and Tenant hereby waive trial

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by jury in any action, proceeding or counterclaim involving any matter whatsoever arising out of, or in any way connected with this Lease, the relationship of Landlord and Tenant hereunder, Tenant's use or occupancy of the Lease Premise, and/or any claim of injury or damage.

3. Hazards Waste. The term "Hazardous Substances", as used in this

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Lease shall mean pollutants, contaminants, toxic or hazardous waste, or any other substances, the use and/or removal of which is restricted, regulated, prohibited or penalized by any "Environmental Law" which term shall mean any federal, state or local law, ordinance, or other statute of a governmental or quasi-governmental authority. Tenant hereby agrees that (i) no activity will be conducted on the premises that will produce any Hazardous Substance, except for such activities that are part of the ordinary course of Tenant's business activities (the "Permitted Activities") provided said Permitted Activities are conducted in accordance with all Environmental Laws and have been approved in advance in writing by Landlord; (ii) the premises will not be used in any manner for the storage of any Hazardous Substance except for the temporary storage of such materials that are used in the ordinary course of Tenant's business (the "Permitted Materials:") provided such Permitted Materials are properly stored in a manner and location meeting all Environmental Laws and provided that such storage and location are approved in advance in writing by Landlord; (iii) Tenant will not permit any Hazardous Substances to be brought onto the premises, except for the Permitted Materials described above, and if so brought or found located thereon, the same shall be immediately removed, with proper disposal, and all required cleanup procedures shall be diligently undertaken pursuant to all Environmental Laws. Landlord

or Landlord's representative shall have the right but not the obligation to enter the premises for the purpose of inspecting the storage, use or disposal of Permitted Materials to insure compliance with all Environmental Laws. Should it be determined, in Landlord's sole opinion, that said Permitted Materials are being improperly stored, used, or disposed of, then Tenant shall promptly reimburse Landlord for any and all costs associated with said work. If at any time during or after the term of the Lease, the premises is found to be so contaminated or subject to said conditions, Tenant shall diligently institute proper and thorough cleanup procedures at Tenant's sole cost, and Tenant agrees to indemnify and hold Landlord harmless from all claims, demands, actions, liabilities, costs, expenses, damages and obligations of any nature arising from or as a result of the use of the premises by Tenant. Landlord shall also have the right to immediately terminate this Lease and dispossess Tenant should Tenant fail to properly discharge its responsibilities of Tenant under this Section shall survive the termination or expiration of this Lease. As of the date hereof, the Landlord represents that it has not been informed by any governmental agency that the property is in violation of any environmental law.

4. Improvements to the Premises. Landlord, at Landlord's sole cost  
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and expense, will complete the following improvements to the Premises prior to the Commencement Date:

- . Shampoo the carpet
- . Clean and wax tile areas
- . Paint the Premises with one (1) coat of Duran (or equivalent latex paint to match existing color
- . Provide new vinyl base along demising wall as shown in Exhibit B, herein.
- . Remove approximately 20 linear feet of existing 1/2 wall as shown crosshatched in Exhibit B.
- . Patch carpeting in areas effected by removal of 1/2 wall.
- . Replace damaged or stained ceiling tiles and window blinds.

Otherwise, the Premises will be delivered "AS IS" and in the configuration as shown in Exhibit B. All other improvements to the Premises shall be made at Tenant's sole cost and expense and under the terms of this Lease.

5. Rental Abatement. Notwithstanding the foregoing, upon  
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substantial completion of above improvements to the Premises as required by the provisions of the Lease, the term shall begin as provided therein, but the rent shall be waived for 14 days thereafter.

AGREEMENT OF LEASE

by and between

ROCKVILLE OFFICE / INDUSTRIAL ASSOCIATES

and

COMTEQ FEDERAL, INC.

EXHIBIT C

Current Rules and Regulations

1. The sidewalks, lobbies, passages, elevators and stairways shall not be obstructed by the Tenant and used by the Tenant for any purpose other than ingress and egress from and to the Tenant's offices. The Landlord shall in all cases retain the right to control or prevent access thereto by any person whose presence, in the Landlord's judgment, would be prejudicial to the safety, peace, character or reputation of the building or of any tenant of the Property.

2. The toilet rooms, water closets, sinks, faucets, plumbing and other service apparatus of any kind shall not be used by the Tenant for any purpose other than those for which they were installed, and no sweepings, rubbish, rags, ashes, chemicals or other refuse or injurious substances shall be placed therein or used in connection therewith by the Tenant, or left by the Tenant in the lobbies, passages, elevators or stairways of the Building.

3. No skylight, window, door or transom of the Building shall be covered or obstructed by the Tenant, and no window shade, blind, curtain, screen, storm window, awning or other material shall be installed or placed on any window or in an window space, except as approved in writing by the Landlord. If the Landlord has installed or hereafter installs any shade, blind or curtain in the Premises, the Tenant shall not remove it without first obtaining the Landlord's written consent thereto.

4. No sign, lettering, insignia, advertisement, notice or other thing shall be inscribed, painted, installed, erected or placed in any portion of the Premises which may be seen from outside the Building, or on any window, window space or other part of the exterior or interior of the Building, unless first approved in writing by the Landlord. Names on suite entrances shall be provided by and only by the Landlord and at the Tenant's expense, using in each instance lettering of a design and in a form consistent with the other lettering in the Building, and first approved in writing by the Landlord. The Tenant shall/will not erect any stand, booth or showcase or other article or matter in or upon the Premises and/or the Building without first obtaining the Landlord's written consent thereto.

5. The Tenant shall not place any additional lock upon any door within the Premises or elsewhere upon the Property, and shall surrender all keys for all such locks at the end of the Term. The Landlord shall provide the Tenant with one set of keys to the Premises when the Tenant assumes possession thereof.

6. The delivery of towels, ice, water, food, beverages, newspapers and other supplies, equipment and furniture will be permitted only under the Landlord's direction and control.

7. The Tenant shall not do or permit to be done anything which obstructs or interferes with the rights of any other Tenant of the Property. The Tenant shall not keep anywhere within the Property any matter having an offensive odor, or any kerosene, gasoline, benzene, camphene,

fuel or other explosive or highly flammable material. No bird, fish or other animal shall be brought into or kept in or about the Premises.

8. So that the Premises may be kept in a good state of preservation and cleanliness, the Tenant shall, while in possession of the Premises, permit only the Landlord's employees and contractors to clean the Premises unless prior thereto the Landlord otherwise consents in writing. The Landlord shall not be responsible to the Tenant for any damage done to any furniture or other property of the Tenant or any other person caused by any of the Landlord's employees or any other person, for any loss sustained by any of the Tenant's employees, or for any loss of property of any kind in or from the Premises, however occurring with the exception of instances where such damage is a result of Landlord's gross negligence or willful misconduct. The Tenant shall see each day that the windows are closed and the doors securely locked before leaving the Premises, and that all lights and standard office equipment within the Premises are turned off.

9. If the Tenant desires to install signaling, telegraphic, telephonic, protective alarm or other wires, apparatus or devices within the Premises, the Landlord shall direct where and how they are to be installed and, except as so directed, no installation, boring or cutting shall be permitted. The Landlord shall have the right (a) to prevent or interrupt the transmission of excessive, dangerous or annoying current of electricity or otherwise into or through the Building or the Premises, (b) to require the changing of wiring connections or layout at the Tenant's expense, to the extent that the Landlord may deem necessary, (c) to require compliance with such reasonable rules as the Landlord may establish relating thereto, and (d) in the event of noncompliance with such requirements or rules, immediately to cut wiring or do whatever else it considers necessary to remove the danger, annoyance or electrical interference with apparatus in any part of the Building. Each wire installed by the Tenant must be clearly tagged at each distributing board and junction box and elsewhere where required by the Landlord, with the number of the office to which such wire leads and the purpose for which it is used, together with the name of the Tenant or other concern, if any, operating or using it.

10. A director will be provided by the Landlord on the ground floor of the Building, on which the Tenant's name may be placed.

11. No furniture, package, equipment, supplies or merchandise may be received in the Building, or carried up or down in the elevators or stairways, except during such hours as are designated for such purpose of the Landlord, and only after the Tenant gives notice thereof to the Landlord. The Landlord shall have the exclusive right to prescribe the method and manner in which any of the same is brought into or taken out of the Building, and the right to exclude from the Building any heavy furniture, safe or other article which may create a hazard and to require it to be located at a designated place in the Premises. The Tenant shall not place any weight anywhere beyond the safe carrying capacity of the Building. The cost of repairing any damage to the Building or any other part of the Property caused by taking any of the same in or out of the Premises, or any damage caused while it is in the Premises or the rest of the Building, shall be borne by the Tenant.

12. Without the Landlord's prior written consent, (a) nothing shall be fastened to (and no hole shall be drilled, or nail or screw driven into) any wall or partition with the exception of pictures, posters, etc., (b) no wall, or partition shall be painted, papered or otherwise covered or moved in any way or marked or broken, (c) no connection shall be made to any electrical wire for running any fan, motor or other apparatus, device or equipment, (d) no machinery of any kind of other than customary small business machinery shall be allowed in the Premises, (e) no switchboard or telephone wiring or equipment shall be placed anywhere other than where designated by the Landlord, and (f) no mechanic shall be allowed to work in or about the Building other than one employed by the Landlord.

13. The Tenant shall have access to the Premises at all times. The Landlord shall in no event be responsible for admitting or excluding any person from the Premises. In case of invasion, hostile attack, insurrection, mob violence, riot, public excitement or other commotion, explosion, fire or any casualty, the Landlord shall have the right to bar or limit access to the Building to protect the safety of occupants of the Property, or any property within the Property.

14. The Landlord shall have the right to rescind, suspend or modify the Rules and Regulations and to promulgate such other Rules or Regulations as, in the Landlord's reasonable judgment, are from time to time needed for the safety, care, maintenance, operation and cleanliness of the Building, or for the preservation of good order therein. Upon the Tenant's having been given notice of the taking of any such action, the Rules and Regulations as so rescinded, suspended, modified or promulgated shall have the same force and effect as if in effect at the time at which the Tenant's lease was entered into (except that nothing in the Rules and Regulations shall be deemed in any way to alter or impair any provision of such lease).

15. The use of any room within the Building as sleeping quarters is strictly prohibited at all times.

16. The Tenant shall keep the windows and doors of the Premises (including those opening on corridors and all doors between rooms entitled to receive heating or air conditioning service and rooms not entitled to receive such service), closed while the heating or air conditioning system is operating, in order to minimize the energy used by, and to conserve the effectiveness of, such systems. The Tenant shall comply with all reasonable Rules and Regulations from time to time promulgated by the Landlord with respect to such systems or their use.

17. Nothing in these Rules and Regulations shall give any Tenant any right or claim against the Landlord or any other person if the Landlord does not enforce any of them against any other tenant or person (whether or not the Landlord has the right to enforce them against such tenant or person), and no such nonenforcement with respect to any tenant shall constitute a waiver of the right to enforce them as to the Tenant or any other tenant or person.

LANDLORD'S LIEN SUBORDINATION

THE STATE OF MARYLAND

KNOW ALL MEN BY THESE PRESENTS:

COUNTY OF MONTGOMERY

THIS SUBORDINATION AGREEMENT (herein the "Agreement") is made as of

\_\_\_\_\_, \_\_\_\_\_ by and between ROCKVILLE

OFFICE/INDUSTRIAL ASSOCIATES, a Limited Partnership (herein "Landlord:") and IBM Credit Corporation (herein "Secured Party"), and COMTEQ FEDERAL, INC. (herein "Tenant").

WHEREAS, Landlord and Tenant have executed that certain lease agreement dated December 14, 1993, a copy of which is attached as Exhibit "A" (herein the "Lease"), for the premises located at 7503 Standish Place, Rockville, Maryland 20855 and more particularly described therein (herein the "Leased Premises");

WHEREAS, Tenant has granted security interests in all of its present and future accounts, inventory, documents, instruments, general intangibles, chattel paper and proceeds thereof (all of the foregoing herein called the "Property") to Secured Party to secure payment of any and all indebtedness, obligations and liabilities of Tenant to Secured Party, now existing or hereafter arising, of whatever kind (herein, the "Debt"); and

WHEREAS, all or part of the Property has been or will be stored or installed in the Leased Premises;

NOW, THEREFORE, for and in consideration of the mutual promises contained herein and the Secured Party's reliance upon the afore described security interest, the receipt and sufficiency of which are hereby acknowledged by the Landlord and the Secured Party, it is hereby agreed by the Landlord and the Secured Party as follows:

1. Landlord subordinates any and all liens, claims, security interests, rights and other encumbrances, contractual, consensual, express, implied, statutory or otherwise, the Landlord may now or hereafter have to the Property by virtue of any tenancy or lease agreement as well as any and all amendments thereto, whether arising by operation of law or equity or otherwise, to the security interest and/or other interests of the Secured Party in the Property.
2. The Secured Party is expressly authorized to enter upon the Leased Premises between the hours of 8:30 a.m. and 5:30 p.m., Monday through Friday, to remove the Property therefrom one (1) day after written notice of such intended entry and removal is given to Landlord. Landlord agrees to provide Secured Party sufficient access to and from the Leased Premises for the removal of the Property. Landlord or Landlord's agent must be present when removal of the Property is being accomplished. Notwithstanding the foregoing, in the event of Tenant's default under its Lease Agreement, Secured Party has the right to cure the same or to remove the Property to which it has any claim within fifteen (15) days of the sending of a written notice from Landlord to remove the Property. If Secured Party does not remove the Property with that time, and should Landlord elect to remove the Property and store the same, such failure shall not impair Secured Party's rights



hereunder, but Landlord may remove the Property and store it, subject to the terms of the Lease, and if such removal and storage is permitted thereunder, then the cost thereof shall be borne (subject to the provisions of Section 8 hereof) by Tenant.

3. Nothing herein contained shall release the Secured Party from, and the Secured Party expressly agrees to be responsible for, the reasonable cost of any repairs as a result of the Secured Party's entry of the Leased Premises and removal of the Property. Secured Party shall reimburse the Landlord for the amount of any such repairs following notice of such repairs from the Landlord.
4. Secured Party, Landlord and Tenant agree that the subordination of Landlord's right described herein (a) shall terminate upon payment in full of the Debt (b) shall extend to any extensions or renewals of the same and (c) is intended to include subordination of, and shall subordinate Landlord's rights with respect to, any mechanic's liens, which may be placed upon the Leased Premises due to any alterations, modifications, improvements or other work at or upon the Leased Premises by Tenant, or its employees, agents, contractors or materialmen.
5. Failure to remove the Property as described in paragraph 2 above shall not render this Agreement null or void. Nothing in this Agreement shall entitle the Secured Party to occupy the Leased Premises for or during any time in which the Tenant is not entitled to occupy the Leased Premises pursuant to the Lease, unless Secured Party has cured any default. Landlord agrees not to sell or otherwise dispose of the Property (other than to store the Property, if Landlord so chooses) for so long as Secured Party shall have a security interest or other claim in the Property without first giving Secured Party at least 15 days notice of its intention to do so, and, in the event of any sale or disposition by Landlord following any such notice, the title transferred by Landlord pursuant to such sale shall be and remain subject to the superior lien of Secured Party. Secured Party shall have right of entry in all storage areas, upon prior notice to Landlord and Landlord shall notify Secured Party of the location of storage. Landlord and Secured Party shall be present for removal from storage of any of the Property.
6. Any notice pursuant to this Agreement shall be deemed to have been given, when received at the following addresses:

SECURED PARTY:                   IBM Credit Corp.  
2707 West Butterfield Road  
Suite 205  
Oak Brook, Illinois 60521  
Attn: Credit Manager

LANDLORD:                         Rockville/Office Industrial Associates  
c/o Trammell Crow NE, Inc.  
7529 Standish Place  
Suite 115  
Rockville, Maryland 20855

7. In the event Secured Party conducts a foreclosure sale on the Property and purchases the Property at such foreclosure sale, Secured Party shall, if the Property has not previously been removed by Secured Party, either (i) remove the Property from the Premises (or, if the Property has been moved by Landlord, from the storage area) within 15 days after the date of such sale, or (ii) pay Landlord rental for the occupation of such space, on a month to month basis, until the Property has been removed by Secured Party, at the then existing monthly rental rate for the Premises under the Lease (or any arm's length extension thereof executed without other consideration); provided, however, that Secured Party shall not be  
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liable for

any such rental for any period during which Secured Party is prohibited from removing the Property by act or omission of Landlord, any bankruptcy stay, injunction, restraining order or other judicial process or any other reason beyond Secured Party's control.

8. Landlord hereby certifies that Tenant is not, and within the last 30 days has not been, in default under the terms of any agreement with Landlord with respect to the rental of the Leased Premises.
9. The undersigned certifies that he has the authority and power to execute this agreement and bind the Landlord to the agreements herein contained and that the Landlord has not assigned or granted a security interest in the rights subordinated herein to any other person.

This Agreement shall be binding upon and inure to the benefit of heirs, representatives, successors and assigns of the Landlord and the Secured Party. The Landlord shall notify any purchaser of the Leased Premises and any subsequent mortgagee or other encumbrance holder of the existence of this Agreement as is appropriate in the circumstances.

SECURED PARTY:  
IBM CREDIT CORPORATION

TENANT:  
COMTEQ FEDERAL, INC.

By: Not legible  
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\_\_\_\_\_

By: /s/ Gary Sorkin  
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Title: A.O.M.  
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Title: President  
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LANDLORD:  
ROCKVILLE OFFICE/INDUSTRIAL  
ASSOCIATES

By: /s/ Donald G. Taylor  
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Title: Managing General Partner  
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FIRST AMENDMENT TO LEASE AGREEMENT

This FIRST AMENDMENT TO LEASE AGREEMENT (hereinafter called the "FIRST AMENDMENT") is made and entered into this 1st day of November, 1996 by and between ROCKVILLE OFFICE/INDUSTRIAL ASSOCIATES, (the "Landlord") and COMTEQ FEDERAL, INC. (the "Tenant").

WITNESSETH

WHEREAS, the Landlord and Tenant entered into a lease (the "Agreement of Lease") dated December 14, 1993 (hereinafter referred to as "the Lease") pursuant to which the Tenant agreed to lease and the Landlord agreed to rent certain premises consisting of approximately 4,169 rentable square feet of floor area ("the Premises") located in a building ("the Building") situated in a subdivision entitled "Gude North", Montgomery County, Maryland more particularly described in the Lease (herein and in the Lease referred to as the "Premises"); and

WHEREAS, the parties hereto wish to amend the Agreement of Lease in order to extend the term and the rental payable and to otherwise to amend the Agreement of Lease as hereinafter set forth.

NOW, THEREFORE, in consideration of the foregoing recitals, the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

- 1. Landlord and Tenant do hereby extend the term of the aforesaid Agreement of Lease for an additional fifteen (15) months commencing January 1, 1997.
2. Section 2.1.1. (a) is hereby amended by deleting the language "the sum of Thirty-Five Thousand Eight Hundred Fifty-Three and 40/100 Dollars (\$35,853.40)" and in lieu thereof inserting the language "the sum of Forty-Five Thousand Eight Hundred Fifty-Nine and 00/100 Dollars (\$45,859.00) as the increased Net Component.
3. Except as expressly amended by this Amendment, the Agreement of Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the day and year first above written.

WITNESS: ROCKVILLE OFFICE/INDUSTRIAL ASSOCIATES, a Texas Limited Partnership
By: CRABBS BRANCH WAY ASSOCIATES LIMITED, its General Partner
By: /s/ Donald G. Taylor
Donald G. Taylor
Managing General Partners

/s/ [ILLEGIBLE]

ATTEST: COMTEQ FEDERAL, INC.

/s/ Gary Sorkin
By: /s/ Scott Shulman
Title: Controller

SECOND AMENDMENT TO LEASE AGREEMENT  
AND EXTENSION OF TERM

THIS SECOND AMENDMENT TO LEASE AGREEMENT AND EXTENSION OF TERM (this "Amendment") is made as of March 31, 1998 by and between METRO PARK LLC, a Delaware limited liability company, successor-in-interest to Rockville Office/Industrial Associates ("the Landlord"), and COMTEQ FEDERAL, INC., a Maryland corporation ("the Tenant").

## RECITALS

WHEREAS, the Landlord and the Tenant are parties to that certain Agreement of Lease dated December 14, 1993, as amended by the First Amendment to Lease Agreement dated November 1, 1996 (collectively, the "Lease"), pursuant to which the Tenant agreed to lease from the Landlord certain premises consisting of approximately 4,169 square feet of space located in a building situated at 7501-7515 Standish Place, Rockville, MD 20855, in Montgomery County, Maryland, as more particularly described in the Lease (the "Original Premises"); and

WHEREAS, the Lease expires by its terms on March 31, 1998 (the "Existing Expiration Date"), the Landlord and the Tenant desire to extend the term of the Lease by a period of five (5) years, upon the terms and subject to the conditions which are hereinafter set forth, and to make certain other amendments to the Lease as described herein.

NOW, THEREFORE, FOR AND IN CONSIDERATION of the mutual entry into this Amendment, and for other good and valuable consideration, the receipt and adequacy of which is hereby acknowledged, the Landlord and the Tenant hereby agree that the Lease is amended, modified and supplemented as follows:

1. **Defined Terms.** All capitalized terms used in this Amendment and not specifically defined herein shall have the meaning ascribed to those terms in the Lease.
2. **Term Extended.** Subject to the provisions of this Amendment, the term of the Lease is hereby amended to expire on March 31, 2003 (the "New Expiration Date"). The period commencing on April 1, 1998 and continuing until the New Expiration Date shall be referred to in this Amendment as the "Extension Term." The term "Extension Lease Year" shall mean (a) the period commencing on April 1, 1998 and terminating on March 31, 1999 and (b) each successive period of twelve (12) calendar months thereafter during the Extension Term. During the Extension Term, (i) all references in the Lease to "Lease Year" shall be deemed to mean

"Extension Lease Year", as defined above, and (ii) all references to "the Term" of the Lease including, without limitation, Subsection 1.1 of the Lease, shall be deemed to include the Extension Term, as defined above.

3. Premises Expanded. The Landlord and the Tenant agree that, effective April 1, 1998, the Original Premises shall be expanded by 4,017 rental square feet of adjoining space as more particularly shown on Exhibit A, so that the total rentable square feet of the Premises shall be 8,186 square feet, and shall include Suites 7503 and 7505.

4. Holding Over. Subsection 1.4.2 of the Lease is hereto amended to provide that in the event the Tenant continues to occupy the Premises after the expiration of the Term or any earlier termination of the Lease without obtaining the Landlord's express consent, the rental payable during the period of such occupancy shall equal two hundred percent (200%) of the rental which was payable under the Lease immediately preceding such expiration or termination, prorated on a per diem basis, together with all damages (direct and consequential) sustained by the Landlord on account thereof.

5. Rent for Extension Period. As of April 1, 1998, Subsection 2.1 of the Lease is hereby deleted and the following inserted in lieu thereof:

2.1. Amount. As rent for the Premises (all of which is hereinafter referred to collectively as "Rent"), the Tenant shall pay to the Landlord all of the following:

2.1.1. Base Rent. An annual rent (hereinafter referred to as "the Base Rent") comprised of the aggregate of the following components:

(a) Net Component-a net component (hereinafter referred to as "the Net Component") which shall be in accordance with the following schedule:

Period	the Net Component
the Commencement Date through March 31, 1999	\$ 90,046.00
through March 31, 2000	\$ 98,232.00
through March 31, 2001	\$106,418.00
through March 31, 2002	\$114,604.00



architectural and engineering fees, labor materials and a construction management fee payable to the Landlord equal to 1.25% of the total construction costs (collectively, "Improvement Costs"). In the event the Improvement Costs exceed Landlord's Contribution, then the Tenant shall pay the entire amount of the excess, in lump sum, within ten (10) days after the Landlord's billing thereof. For purposes of this paragraph, "Building Standard" means materials and finishes of the quality and character customarily offered by the Landlord to new tenants of the Building as its "standard" or base level.

5.1.2 The Tenant acknowledges that the Tenant has inspected the Premises, and except as specifically provided in the foregoing paragraph, the Tenant agrees to accept the Premises and the Building and improvements comprising same "AS IS", in their present condition, as suitable for the purpose for which the Premises are leased, as more particularly provided in Section 2 of this Lease (as modified by the Addendum).

5.1.3 The Landlord shall use reasonable efforts to complete such improvements as soon as practical. In the event the improvements described in subsection 5.1.1 are not substantially completed prior to the commencement of the Extension Term through no fault of the Tenant, the Extension Term shall not be extended or modified, but until such improvements are substantially completed, the Tenant shall continue to occupy the Original Premises, and shall pay as Rent for the Original Premises the Base Rent and other Rent provided for under the Lease during the period immediately preceding the commencement of the Extension Term. Should occupancy of the entire Premises become available other than on the first day of a calendar month, the Rent shall be adjusted on a daily basis, based on one three-hundred sixty-fifth (1/365) of the full Rent, for each day of such calendar month when occupancy of the entire Premises had been available to the Tenant.

5.1.4. In the event the Tenant vacates the Premises and there is a default in the payment of Rent under this Lease, or in the event the Landlord obtains possession of the Premises or terminates the Lease by reason of a Default by the Tenant, the Tenant shall pay to the Landlord, upon demand, as additional rent hereunder, the full unamortized amounts (based on an amortization period of five (5) years and including interest at 11.00% per annum on the outstanding principal balance) of Landlord's Contribution.

9. Insurance. As of May 1, 1998, Section 4 of the Lease is hereby  
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deleted in its entirety and Section 4 attached hereto as Exhibit B is  
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substituted in its place.

10. Landlord's Rights. As of May 1, 1998, Section 7 of the Lease is  
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hereby deleted in its entirety and Section 7 attached hereto as Exhibit C is  
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substituted in its place.

11. Disabilities Act. The parties acknowledge that the Americans With  
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Disabilities Act of 1990 (42 U.S.C. (S) 1210 et seq.) and regulations and  
guidelines promulgated thereunder ("ADA"), and any similarly motivated state and  
local laws ("Local Barriers Act"), as the same



may be amended and supplemented from time to time (collectively referred to herein as the "Disabilities Acts") establish requirements for business operations, accessibility and barrier removal, and that such requirements may or may not apply to the Premises, Building or Property depending on, among other things: (i) whether the Tenant's business is deemed a "public accommodation" or "commercial facility", (ii) whether such requirements are "readily achievable", and (iii) whether a given alteration affects a "primary function area" or triggers "path of travel" requirements. The Landlord and the Tenant hereby agree that: (a) the Landlord shall perform any required ADA Title II and related Local Barriers Acts compliance in the common areas of the Building, except as provided below, (b) the Tenant shall perform any required ADA Title III and related Local Barriers Acts compliance in the Premises, and (c) the Landlord may perform, or require the Tenant to perform, and the Tenant shall be responsible for the cost of, ADA Title III and related Local Barriers Acts "path of travel" and other requirements triggered by any public accommodation or other use of, or alterations in the Premises, and (d) the Tenant shall be responsible for ADA Title I and related Local Barriers Acts requirements relating to the Tenant's employees, and the Landlord shall be responsible for ADA Title I and related Local Barriers Acts requirements relating to the Landlord's employees.

12. Estoppel Certificates. The Tenant shall from time to time, within

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five (5) days after written request from the Landlord, execute, acknowledge and deliver a statement certifying: (i) that the Lease is unmodified and in full force and effect or, if modified, stating the nature of such modification and certifying that the Lease as so modified, is in full force and effect (or specifying the ground for claiming that the Lease is not in force and effect), (ii) the dates to which the Rent has been paid, and the amount of any Security Deposit, (iii) that the Tenant is in possession of the Premises, and paying Rent on a current basis with no offsets, defenses or claims, or specifying the same if any are claimed, (iv) that there are not, to the Tenant's knowledge, any uncured defaults on the part of the Landlord or the Tenant which are pertinent to the request, or specifying the same if any are claimed, and (v) certifying such other matters, and including such current financial statements, as the Landlord may reasonably request, or as may be requested by the Landlord's current or prospective Lenders, insurance carriers, auditors, and prospective purchasers (and including a comparable certification statement from any subtenant respecting its sublease). Any such statement may be relied upon by any such parties. If the Tenant shall fail to execute and return such statement within the time required herein, the Tenant shall be deemed to have agreed with the matters set forth therein, and the Landlord acting in good faith shall be authorized as the Tenant's agent and attorney-in-fact to execute such statements on behalf of the Tenant (which shall not be in limitation of the Landlord's other remedies).

13. Authority. Each party hereto hereby represents and warrants to the

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other that the representing party has full power, authority and legal right to execute, enseat, acknowledge and deliver this Amendment and that this Amendment constitutes the representing party's binding legal obligation.

14. Counterpart Execution. This Amendment may be executed in two or more

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counterparts, each of which shall be deemed to be an original, but all of which together shall

constitute one and the same instrument and shall not become effective unless and until executed and delivered to each party.

15. Effective of this Amendment. Except as herein set forth, the

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provisions of the Lease shall remain in full force and effect and all references to the Lease shall be deemed to mean the Lease as amended by this Amendment.

16. Effectiveness of Amendment. The effectiveness of this Amendment is

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subject to the express condition that no Event of Default shall have occurred which as of the Existing Termination Date had not theretofore been remedied.

17. Real Estate Broker. The Tenant represents that the Tenant has dealt

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only with Insignia/Barnes Morris (whose commission, if any, shall be paid by the Landlord pursuant to separate agreement) as broker, agent or finder in connection with this Amendment, and agrees to indemnify and hold the Landlord harmless from all damages, judgments, liabilities and expenses (including reasonable attorneys' fees) arising from any claims or demands of any other broker, agent or finder with whom the Tenant has dealt for any commission or fee alleged to be due in connection with its participation in the procurement of the Tenant or the negotiation with the Tenant of this Amendment.

18. Deletion of Addendum Provisions. Paragraphs 4 and 5 of the lease

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provisions contained on the rider attached to the original Lease, totaled "Improvements to the Premises" and "Rent Abatement," are hereby deleted.

IN WITNESS WHEREOF each party hereto has executed and ensealed this Amendment or caused it to be executed and ensealed on hits behalf by its duly authorized representatives as of the day and year first above written.

The Landlord:

WITNESS: METRO PARK, LLC

By: \_\_\_\_\_

By: /s/ Tim Cahill [SEAL]

Name:  
Title:

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Name: not legible  
Authorized Signatory

The Tenant:

ATTEST TO: COMTEQ FEDERAL, INC.

By: /s/ Debbie Kearns  
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By: /s/ Scott Shulman [SEAL]  
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Name: Debbie Kearns  
Title: Admin

Name: Scott Shulman  
Title: Controller

This page is the signature page of that SECOND LEASE MODIFICATION AND EXTENSION OF TERM made as of March 31, 1998 by and between METRO PARK, LLC, and COMTEQ FEDERAL, INC.

EXHIBIT B

Section 4: INSURANCE AND WAIVER OF CLAIMS

A. Required Insurance. The Tenant shall maintain at its expense during

the Term with respect to the Premises and the Tenant's use thereof and of the Building and the Property:

(i) Worker's Compensation Insurance in the amounts required by statute,

and Employer Liability Insurance in at least the following amounts: (a) Bodily Injury by Accident - \$500,000 per accident, (b) Bodily Injury by Disease - \$500,000 per employee, and (c) Aggregate Limit - \$1,000,000 per policy year.

(ii) Property Damage Insurance for the protection of the Tenant and the

Landlord, as their interests may appear, covering any alterations or improvements in excess of any work provided or paid for by the Landlord under the Lease, the Tenant's personal property, business records, fixtures and equipment, and other insurable risks in amounts not less than the full insurable replacement cost of such property and full insurable value of such other interests of the Tenant, with coverage at least as broad as the most recent editions published by Insurance Services Office, Inc. or any successor organization ("ISO"), of: (a) Building and Personal Property Coverage Form (CP1030), (b) Business Income Coverage Form (CP0030), covering at least one year of anticipated income, (c) Boiler and Machinery Coverage Form (BM0025), (d) Causes of Special Loss Form (CP1030), and (e) Sprinkler Leakage - Earthquake Extension (CP1039).

(iii) Commercial General Liability Insurance ("CGL") at least as broad as

the most recent ISO edition of Commercial General Liability Coverage Form (CG0001) with limits of at least the following amounts: (a) Death or Bodily Injury - \$2,000,000, (b) Property Damage or Destruction (including loss of use thereof) - \$1,000,000, (c) Each Occurrence Limit - \$2,000,000, and (f) General Aggregate Limit - \$3,000,000 per policy year. Such policy shall include endorsements: (1) for contractual liability covering the Tenant's indemnity obligations under this Lease, and (2) adding the Landlord, the management company for the Building and the Property, and other parties designated by the Landlord, as Additional Insureds, on a form at least as broad as the most recent edition of Additional Insured - Manager or Lessor of Premises Endorsement Form (CG2011) published by ISO.

B. Certificates, Subrogation and Other Matters. The Tenant shall

provide the Landlord with certificates evidencing the coverage required hereunder prior to the Commencement Date, or the Tenant's entry to the Premises for construction of improvements or any other purpose (whichever first occurs). Such certificates shall: (i) be on ACORD Form 27 or such other form approved or required by the Landlord, (ii) state that such insurance coverage may not be changed, canceled or non-renewed without at least thirty (30) days prior written

notice to the Landlord, and (iii) include, as attachments, originals of the Additional insured endorsements to the Tenant's CGL policy required above. The Tenant shall provide renewal certificates to the Landlord at least thirty (30) days prior to expiration of such policies. Except as expressly provided to the contrary herein, coverage hereunder shall apply to events occurring during the policy year regardless of when a claim is made. The Landlord may periodically require that the Tenant reasonably increase or expand the aforementioned coverage. Except as provided to the contrary herein, any insurance carried by the Landlord or the Tenant shall be for the sole benefit of the party carrying such insurance. If the Tenant obtains insurance under "blanket policies," the Tenant shall obtain an endorsement providing that the insurance limits required hereunder are not subject to reduction or impairment by claims or losses at other locations. The Tenant's insurance policies shall be primary to all policies of the Landlord and any other Additional insureds (whose policies shall be deemed excess and non-contributory). All insurance required hereunder shall be provided by responsible insurers licensed in the State of Maryland, and shall have a general policyholder's rating of at least A and a financial rating of at least X in the then current edition of Best's Insurance Reports. The parties mutually hereby waive all rights and claims against each other for all losses covered by their respective insurance policies, and waive all rights of subrogation of their respective insurers. The parties agree that their respective insurance policies are now, or shall be, endorsed such that said waiver of subrogation shall not affect the right of the insured to recover thereunder. The Landlord disclaims any representation as to whether the foregoing coverages will be adequate to protect the Tenant, and the Tenant agrees to carry such additional coverage as may be necessary or appropriate.

C. Waiver of Claims. Except for claims arising from the Landlord's

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intentional or grossly negligent acts which are not covered or required to be covered by the Tenant's insurance hereunder, the Tenant waives all claims against the Landlord for injury or death to persons, damage to property or to any other interest of the Tenant sustained by the Tenant or any party claiming by or through the Tenant resulting from: (i) any occurrence in or upon the Premises, (ii) leaking of roofs, bursting, stoppage or leaking of water, gas, sewer or steam pipes or equipment, including sprinklers, (iii) wind, rain, snow, ice, flooding (including flooding of basements and other subsurface areas), freezing, fire, explosion, earthquake, excessive heat or cold, dampness, fire or other casualty, (iv) the Property, Building, Premises, systems and equipment being defective, out of repair, or failing, and (v) vandalism, malicious mischief, theft, misappropriation or other acts or omissions of any parties including the Tenant's employees, other tenants, and their respective agents, employees, invitees and contractors (and the Tenant shall give the Landlord immediate notice of any such occurrences). To the extent that the Tenant is required to or does carry insurance hereunder, the Tenant agrees that the Tenant's property loss risks shall be borne by such insurance, and the Tenant agrees to seek recovery only from its insurance carriers in the event of such losses; for purposes hereof, any deductible amount shall be treated as though it were recoverable under such policies. This provision is in addition to, and not in limitation of, other provisions of the Lease limiting the Landlord's liability.

D. Liability of Parties. Except if and to the extent that such party is

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released from liability to the other party hereto pursuant to the provisions of Paragraph B;

(i) the Landlord (a) shall be responsible for, and shall indemnify and hold harmless the Tenant against and from any and all liability arising out of, any injury to or death of any person or damage to any property, occurring anywhere upon the Property, if, only if and to the extent that such injury, death or damage is proximately caused by the negligent or intentionally tortious act or omission of the Landlord or its agents, officers or employees, but (b) shall not be responsible for or be obligated to indemnify or hold harmless the Tenant against or from any liability for any such injury, death or damage occurring anywhere upon the Property (including the Premises), (i) by reason of the Tenant's occupancy or use of the Premises or any other portion of the Property, or (ii) because of fire, windstorm, act of God or other cause unless proximately caused by such negligent or intentionally tortious act or omission of the Landlord, as aforesaid; and

(ii) subject to the operation and effect of the foregoing provisions of this subsection, the Tenant shall be responsible for, and shall defend, indemnify and hold harmless the Landlord against and from, any and all liability or claim of liability arising out of any injury to or death of any person or damage to any property, occurring within the Premises, unless resulting from fire, windstorm, act of God or other cause not proximately caused by the negligent or intentionally tortious act or omission of the Tenant, or any of their respective officers, employees, or agents.

EXHIBIT C

Section 7: LANDLORD'S RIGHTS

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Except to the extent expressly limited herein, the Landlord reserves full rights to control the Building and the Property (which rights may be exercised without subjecting the Landlord to claims for constructive eviction, abatement of Rent, damages or other claims of any kind), including more particularly, but without limitation, the following rights:

A. General Matters. To: (i) change the name or street address of the

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Building or the Property or designation of the Premises, (ii) install and maintain signs on the exterior and interior of the Building or the Property, and grant any other Person the right to do so, (iii) retain at all times, and use in appropriate instances, keys to all doors within and into the Premises, (iv) grant to any Person the right to conduct any business or render any service at the Building or the Property, whether or not the same are similar to the use permitted the Tenant by this Lease, (v) grant any Person the right to use separate security personnel and systems respecting access to their premises, (vi) have access for the Landlord and other Tenants of the Building or the Property to any mail chutes located on the Premises according to the rules of the United States Postal Service (and to install or remove such chutes), and (vii) in case of fire invasion, insurrection, riot, civil disorder, public excitement or other dangerous condition, or threat thereof: (a) limit or prevent access to the Building or the Property, (b) shut down elevator service, (c) activate elevator emergency controls, and (d) otherwise take such action or preventative measures deemed necessary by the Landlord for the safety of the Tenants of the Building or the Property or the protection of the Building or the Property and other property located thereon or therein (but this provision shall impose no duty on the Landlord to take such actions, and no liability for actions taken in good faith).

B. Access To Premises. To enter the Premises in order to: (i) inspect,

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(ii) supply cleaning service or other services to be provided the Tenant hereunder, (iii) show the Premises to current and prospective Lenders, insurers, purchasers, tenants, brokers and governmental authorities, (iv) decorate, remodel or alter the Premises if the Tenant shall abandon the Premises at any time, or shall vacate the same during the last 120 days of the Term (without thereby terminating this Lease), and (v) perform any work or take any other actions under Paragraph C below, or exercise other rights of the Landlord under this Lease or applicable laws. However, the Landlord shall: (a) provide reasonable advance written or oral notice to the Tenant's on-site manager or other appropriate person for matters which will involve a significant disruption to the Tenant's business (except in emergencies), (b) take reasonable steps to minimize any significant disruption to the Tenant's business, and following completion of any work, return the Tenant's leasehold improvements, fixtures, property and equipment to the original locations and condition to the fullest extent reasonably possible, and (c) take reasonable steps to avoid materially changing the configuration or reducing the square footage of the Premises, unless required by laws or other causes beyond the Landlord's reasonable control (and in the event of any

permanent material reduction, the Rent and other rights and obligations of the parties based on the square footage of the Premises shall be proportionately reduced). The Tenant shall not place partitions, furniture or other obstructions in the Premises which may prevent or impair the Landlord's access to the systems and equipment for the Building or the systems and equipment for the Premises. If the Tenant requests that any such access occur before or after the Landlord's regular business hours and the Landlord approves, the Tenant shall pay all overtime and other additional costs in connection therewith.



C. Changes To The Building or the Property. To: (i) paint and decorate,

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(ii) perform repairs or maintenance, (iii) add land, buildings, easements or other interests to, or sell or eliminate the same from, the Building or the Property, and grant interests and rights in the Building or the Property to other parties, and convert common areas to rentable areas and rentable areas to common areas, and (iii) make replacements, restorations, renovations, alterations, additions and improvements, structural or otherwise (including freon retrofit work), in and to the Building or the Property or any part thereof, including any adjacent building, structure, facility, land, street or alley, or change the uses thereof (other than the Tenant's permitted use), including changes, reductions or additions of corridors, entrances, doors, lobbies, parking facilities and other areas, structural support columns and shear walls, elevators, stairs, escalators, mezzanines, solar tint windows or film, kiosks, planters, sculptures, displays, and other amenities and features therein, and changes relating to the connection with or entrance into or use of the Building or the Property or any other adjoining or adjacent building or buildings, now existing or hereafter constructed. In connection with such matters, the Landlord may among other things erect scaffolding, barricades and other structures, open ceilings, close entry ways, restrooms, elevators, stairways, corridors, parking and other areas and facilities, and take such other actions as the Landlord deems appropriate. However, the Landlord shall: (a) take reasonable steps to minimize or avoid any denial of access to the Premises except when necessary on a temporary basis, and (b) in connection with entering the Premises shall comply with Paragraph B above.

## THIRD AMENDMENT TO AGREEMENT OF LEASE

THIS THIRD AMENDMENT TO AGREEMENT OF LEASE ("Amendment") is made on this 31st day of August, 2000, by and between METRO PARK I, LLC, a Delaware  
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limited liability company ("Landlord") and COMTEQ FEDERAL, INC., a Maryland corporation ("Tenant").

## BACKGROUND

A. Rockville Office/Industrial Associates ("ROIA") entered into a certain Agreement of Lease, dated November 1, 1996 (the "Original Lease"), pursuant to which ROIA leased to Tenant certain premises consisting of approximately 4,169 rentable square feet (the "Original Premises") located at 7503 Standish Place, Rockville, Montgomery County, Maryland. The Original Premises is more fully described in the Original Lease.

B. On November 12, 1996, ROIA and Tenant entered into a certain First Amendment to Lease Agreement ("First Amendment"), pursuant to which the terms and conditions of the Original Lease were amended to reflect an extension in the term of the Original Lease and an increase in the amount of Base Rent due under the Original Lease.

C. After the execution of the First Amendment, Metro Park I, LLC, succeeded to the right, title and interest of ROIA in and to the Original Premises and all of ROIA's right, title and interest as the "Landlord" under the Original Lease and the First Amendment was assigned to Metro Park I, LLC.

D. On March 31, 1998, Landlord and Tenant entered into a certain Second Amendment to Lease and Extension of Term ("Second Amendment"), pursuant to which the terms and conditions of the Original Lease were amended to reflect (i) an extension in the term of the Original Lease (ii) the leasing of additional space consisting of approximately 4,017 rentable square feet of space adjoining the Original Premises (the "Added Premises") at 7503 and 7505 Standish Place, Rockville, Montgomery County, Maryland (the Added Premises and the Original Premises shall be collectively referred to as the "Premises"), and (iii) other modifications to the Original Lease, as more fully described in the Second Amendment.

E. The Original Lease First Amendment and Second Amendment are collectively referred to as the Lease in this Amendment.

F. Landlord and Tenant desire to amend the Lease (I) to expand the Premises by adding 2,010 rentable square feet of space at 7501 Standish Place (the "Additional Premises"), as such space is more particularly shown outlined and hatched in black on the floor plan attached hereto as Exhibit A, and (ii) to -----  
otherwise modify and amend the Lease, all as set forth in this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants and conditions set forth in this Amendment and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Demise of Additional Premises.  
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a. Landlord hereby leases, demises and lets unto Tenant the Additional Premises, and Tenant hereby takes and hires the Additional Premises from Landlord, for the period commencing on the later of (i) July 1, 2000, or (ii) the date on which possession of the Additional Premises is delivered to Tenant (as applicable, the "Additional Premises Commencement Date"), and expiring at midnight on March 31, 2003 (the "New Expiration Date"). Effective on the Additional Premises Commencement Date, the Additional Premises shall (i) be added to and become a part of the Premises, which shall then contain an aggregate of 10,196 rentable square feet (as agreed by Landlord and Tenant), and (ii) be governed by all of the provisions of the Lease, as amended hereby. Tenant hereby agrees to accept the Additional Premises in its "AS IS" condition as of the Additional Premises Commencement Date. Tenant acknowledges that neither Landlord, nor Landlord's agents, representatives, employees, servants or attorneys have made or will make any representations or promises, whether express or implied, concerning the condition of the Additional Premises, and agrees that Landlord shall have no obligation to make any alterations or improvements to the Additional Premises.

b. If the Additional Premises Commencement Date does not occur on July 1, 2000, (I) the New Expiration Date shall not be changed, unless Landlord so elects by notice to Tenant, and (ii) Landlord and Tenant shall execute a confirmation of the commencement date, the expiration date and other matters in substantially the form of Exhibit B hereto within ten (10) days after request by

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the other to do so. Any failure by either party to respond within such time shall be deemed an acceptance of the matters as set forth in the confirmation. If Tenant disagrees with Landlord's adjustment of the Additional Premises Commencement Date, Tenant shall pay Rent and perform all other obligations commencing on the date determined by Landlord, subject to refund or credit when the matter is resolved.

2. Adjustment of Base Rent and Additional Rent  
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a. Effective on the Additional Premises Commencement Date, Tenant shall pay to Landlord for the Additional Premises yearly Base Rent equal to \$47,235.00, in monthly installments equal to \$3,936.25, which is equal to \$23.50 per rentable square foot. Such Base Rent shall be in addition to the yearly Base Rent due for the balance of the Premises (until the expiration of the term of the Lease with respect to such space). On last day of the month in which the first anniversary of the Additional Premises Commencement Date occurs and on the same date each calendar thereafter included in the term of the Lease, the Base Rent for the Additional Premises shall be increased by an amount equal to the product of (A) the yearly Base Rent due for the Additional Premises for the twelve month period then ending, and (B) three percent (3%).

b. Effective on the Additional Premises Commencement Date, Tenant's Share shall be increased to reflect the addition of the Additional Premises from 4.9% percent to 6.1% percent, which is the ratio that the rentable square foot area of the Premises (i.e. 10,196 rentable square feet, as agreed by Landlord and Tenant) bears to the total rentable square foot area of the Building (i.e. 166,760 rentable square feet, as agreed by Landlord and Tenant). In addition to the Base Rent payable by Tenant under paragraph (a) above, Tenant shall pay to Landlord with respect to the Additional Premises, at the times and in the manner set forth in the Lease, an amount equal to (i) Tenant's Share of Taxes in excess of Taxes for the 2000 calendar year, and (ii) Tenant's Share of Expenses in excess of Expenses for the 2000 calendar year, excluding any Expenses for the Base Year that are non-recurring.

3. Extension of Term. The term of the Lease with respect to the balance  
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of the Premises is hereby extended until the New Expiration Date, and all references in the Lease to the Expiration Date shall be deemed to mean the New Expiration Date. All provisions of the Lease, as amended hereby and except as otherwise expressly set forth herein, shall apply to such extended term.

4. Brokers. Landlord and Tenant each represent that it has not dealt  
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with any broker, agent, finder or other person in connection with the negotiation for or the obtaining of this Amendment, and that no broker, agent, finder or other person brought about the transaction contemplated by this Amendment, other than Insignia/ESG. Landlord and Tenant shall indemnify, defend and hold the other harmless from and against any and all claims, lawsuits, liabilities, damages and costs, including attorneys' fees, incurred by the other by reason of any breach of the foregoing warranty. Landlord shall pay Insignia/ESG any commission earned by it in connection with this Amendment pursuant to a separate agreement.

5. Ratification of Lease. Except as specifically modified by this  
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Amendment, all of the provisions of the Lease are hereby ratified and confirmed to be in full force and effect, and shall remain in full force and effect, including, without limitation, all remedies reserved to Landlord, with which remedies Tenant hereby acknowledges complete familiarity, and which remedies are incorporated herein by reference as though set forth in their entirety.

6. Binding Effect. This Amendment shall be binding upon, and shall inure  
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to the benefit of Landlord and Tenant and their respective heirs, executors, personal representatives, administrators, successors and permitted assigns.

7. Governing Law. This Amendment shall be governed by and construed in  
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accordance with the laws of the State of Maryland.

8. Offer. The submission and negotiation of this Amendment shall not be  
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deemed an offer to enter the same by Landlord (nor an option or reservation for the Additional Premises), but the solicitation of such an offer by Tenant. Tenant agrees that its execution of this Amendment constitutes a firm offer to enter the same which may not be withdrawn for a period of ten (10) days after delivery to Landlord. During such period and in reliance on the foregoing, Landlord may, at Landlord's option, deposit any Security Deposit and Rent, proceed with any

plans, specifications, alterations or improvements, and permit Tenant to enter the Additional Premises, but such acts shall not be deemed an acceptance of Tenant's offer to enter this Amendment, and such acceptance shall be evidenced only by Landlord signing and delivering this Amendment to Tenant.

IN WITNESS WHEREOF, Landlord and Tenant have caused this Amendment to be executed by their respective duly authorized representatives as of the day and year first above written.

METRO PARK I, LLC,  
a Delaware limited liability company

By: Not legible  
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Name:  
Its: Authorized Signatory

(Corporate Seal)

By: /s/ Janet Giuliani  
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Name: Janet Giuliani  
Its: Authorized Signatory

COMTEQ FEDERAL, INC.

By: /s/ Gary Sorkin  
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Name: Gary Sorkin  
Title: President

(Corporate Seal)

Attest: /s/ Scott Shulman  
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Name: Scott Shulman  
Title: Controller

EXHIBIT A

[Attach Diagram of the Additional Premises]



AMENDMENT NO. 3 TO LEASE

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THIS AGREEMENT made this 26th day of June, 2000 , by and between EWE

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WAREHOUSE INVESTMENTS V, LTD., SUCCESSOR TO MILLER-VALENTINE PARTNERS, as Lessor and MERRIMACK SERVICES CORPORATION dba PC CONNECTION SERVICES, SUCCESSOR TO PC CONNECTION, INC., as Lessee located at 2870 Old State Route 73, Wilmington, Ohio 45177.

WITNESSETH:

WHEREAS, Lessor and Lessee entered into a Lease dated September 27, 1990 as amended June 28, 1996 and July 31, 1998, and

WHEREAS, Lessor acknowledges the assignment of the lease and amendments from PC Connection, Inc. to Merrimack Services Corporation.

WHEREAS, the Lessor and Lessee desire to amend the Lease of approximately 38,400 square feet to expand the Leased Premises, extend the term and add an option to renew.

NOW THEREFORE, the Lease is amended as follows.

1. Effective January 1, 2001 and simultaneously upon the expiration of the Sublease Agreement by and between ABX Air, Inc. ("SUBLESSOR") and MERRIMACK SERVICES CORPORATION ("SUBLESSEE") dated June 7, 1995, the Lessee shall lease from the Lessor an additional 64,000 square feet at 2840 Old State Route 73, Wilmington, Ohio 45177 for a total of 102,400 square feet of Leased Premises located at 2840-2870 Old State Route 73, Wilmington, Ohio 45177 which is 100% of the total area of the building.

2. Article 1. TERM. shall be revised as follows.

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Effective January 1, 2001 the term of this Lease shall be extended for a period of two (2) years for a term now totaling twelve (12) years commencing January 1, 1991 and ending December 31, 2002, both dates inclusive.

3. The Revised Leased Premises shall be delivered to the Lessee "as-is" since the Lessee is currently occupying the Premises.

4. Article 4. RENT. Section 1. shall be revised as follows.

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Lessee shall pay to the Lessor as Basic Annual Rent for the Revised Leased Premises for the period of January 1, 2001 through December 31, 2001 the sum of FIVE HUNDRED TWELVE THOUSAND AND 04/100 DOLLARS (\$512,000.04) which shall be paid in equal monthly installments of FORTY-TWO THOUSAND SIX HUNDRED SIXTY-SIX AND 67/100 DOLLARS (\$42,666.67), due and payable on the first day of each month, in advance, without demand. Said rent shall be paid to the Lessor, or to the duly authorized agent of the Lessor,

at its office during business hours. If the commencement date of this Lease is other than the first day of the month, any rental adjustment or additional rents hereinafter provided for shall be prorated accordingly. The Lessee will pay the rent as herein provided, without deduction whatsoever, and without any obligation of the Lessor to make demand for it. Any installment of rent accruing hereunder and any other sum payable hereunder, if not paid when due, shall bear interest at the rate of eighteen percent (18%) per annum until paid. The Basic Annual Rent of \$512,000.04 shall be adjusted on January 1, 2002 based on any increases in the Consumer Price Index. Increases in the Annual Rent shall be made in accordance with the following procedure:

a. The index to be used for this adjustment shall be the Consumer Price Index (U.S. City Average, All Urban Consumers, All Items, 1982-1984 equaling a base of 100, from the U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C.).

b. The Consumer Price Index of 2000 for the month of September shall be the "Base Period Consumer Price Index". The Consumer Price Index for the month of September in each adjustment year shall be the "Adjustment Period Consumer Price Index".

c. The Base Period Consumer Price Index shall be subtracted from the Adjustment Period Consumer Price Index; the difference shall be divided by the Base Period Consumer Price Index. This quotient shall then be multiplied by the Basic Annual Rent, and the result shall then be added to the Basic Annual Rent. The resulting sum shall be the adjusted Annual Rent for such immediately succeeding leasehold period which shall be paid in equal monthly installments. Provided however, no annual increase shall be less than 3%.

d. If the said Consumer Price Index is, at any time during the term of this Lease, discontinued by the Government, then the most nearly comparable index shall be substituted for the purpose of the aforesaid calculations.

Section 2. remains unchanged.

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Section 3. shall be replaced by the following.

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The Lessee shall pay as additional rent throughout the lease term and any extensions thereof, its proportionate share of any real estate taxes and/or assessments (including special assessments) assessed against the industrial building of which the Leased Premises is a part of, and which shall be due and payable with respect to the land and improvements situated within the said industrial building. The Lessee's proportionate share shall be a fraction thereof, the numerator of which is the number of square feet of floor area in the Leased Premises and the denominator of which is the total square feet of the floor area in the building both as specified aforesaid in the Lease. Said amount shall be deemed to be additional rent and shall be due and payable on the first of the month following delivery to Lessee of an invoice for said real estate taxes. The Lessee shall pay its prorated share of expenses that the Lessor shall incur by reason of compliance with new laws, orders, special rent/use taxes, charges for governmental services, ordinances and new regulations of Federal, State, County and Municipal authorities, and with any lawful direction of any public officer or officers, which lawful direction shall be imposed upon the Lessor for the common good of the occupants of the building.

5. RIGHT OF FIRST OFFERING ON CURRENTLY OCCUPIED SPACE. shall be

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deleted in its entirety. (As defined in Item #1 of Amendment No. 2 dated July 31, 1998.)

6. OPTION TO RENEW. shall be added as follows.

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Lessee is hereby granted an option to renew this Lease for an additional term of two (2) years on the same terms

and conditions contained herein except for the rental and the length of the term, upon the conditions that:

a. written notice of the exercise of such option shall be given by Lessee to Lessor not less than one hundred eighty (180) days prior to the end of the term of this Lease; and

b. at the time of the giving of such notice and at the expiration of the term of this Lease, there are no defaults in the covenants, agreements, terms and conditions on the part of Lessee to be kept and performed, and all rents are and have been fully paid. Provided also, that the rent to be paid during each year of the said renewal period shall be as determined in accordance with the following procedure:

(1) The index to be used for this adjustment shall be the Consumer Price Index (U.S. City Average, All Urban Consumers, All Items, 1982-1984 equaling a base of 100, from the U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C.).

(2) The Consumer Price Index of 2000 for the month of September shall be the "Base Period Consumer Price Index".

(3) The Consumer Price Index for the month of September each succeeding year shall be determined from the published figures and shall be the "Adjustment Period Consumer Price Index".

(4) The Base Period Consumer Price Index shall be subtracted from the Adjustment Period Consumer Price Index; the difference shall be divided by the Base Period Consumer Price Index. This quotient shall then be multiplied by \$512,000.04 and the result shall then be added to \$512,000.04. This arithmetical sum shall then be the adjusted Basic Annual Rent for such immediately succeeding leasehold year which shall be paid in equal monthly installments. Provided however, no annual increase shall be less than 3%.

(5) If the said Consumer Price Index is, at any time during the term of this Lease, discontinued by the Government, then the most nearly comparable index shall be substituted for the purpose of the aforesaid calculations.

7. Except as expressly amended herein, all other terms and conditions of the Lease remain in full force and effect.

IN WITNESS WHEREOF, the Lessor and Lessee have affixed their signatures to duplicates of this Amendment, this 16th day of June, 2000, as to Lessee and this 26th day of June 2000, as to Lessor.

Signed and acknowledged LESSOR: EWE WAREHOUSE INVESTMENTS V, LTD.  
in the presence of: BY MILLER-VALENTINE REALTY, INC.  
ITS MANAGING AGENT

/s/Barbara Gilmore By: /s/ Robert A. Gallinis  
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Robert A. Gallinis  
/s/Peter A. Hughes Title: President  
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LESSEE: MERRIMACK SERVICES CORPORATION

/s/ R.A. Pratt By: /s/Wayne L. Wilson  
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Dir. Of Facilities Title: President  
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STATE OF OHIO, COUNTY OF MONTGOMERY, SS:

The foregoing instrument was acknowledged before me this 26th day of June 2000 by Robert A. Gallinis, President, of Miller-Valentine Realty, Inc., managing agent for EWE WAREHOUSE INVESTMENTS V, LTD.

/s/Peter A Hughes

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NOTARY PUBLIC

STATE OF New Hampshire, COUNTY OF Hillsborough, SS:

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The foregoing instrument was acknowledged before me this 16th day of June 2000 by Wayne L. Wilson, the President of MERRIMACK SERVICES CORPORATION, a corporation on behalf of said corporation.

/s/ Dolores R. Collins

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NOTARY PUBLIC

## L E A S E

AGREEMENT made this 5th day of January, 2000, by and between The Hillsborough Group, a General Partnership, duly authorized under the laws of the State of New Hampshire, with a principal place of business at 436 South River Road, Bedford, County of Hillsborough and State of New Hampshire (hereinafter called "Lessor"), and PC Connection, Inc., with a principal place of business located at Route 101A, 730 Milford Road, Merrimack, New Hampshire 03054 (hereinafter called "Lessee").

WHEREAS, Lessor owns a certain building in Merrimack, New Hampshire; and

WHEREAS, Lessee desires to lease space in same,

NOW, THEREFORE, THE PARTIES AGREE AS FOLLOWS:

1. PREMISES: The premises to be leased comprise an area of 9,688 square feet, -----  
more or less, which is located in said building located at 706 Route 101A, Merrimack, New Hampshire;
  2. TERM: The term of this lease shall consist of a term of fifteen (15) -----  
months, commencing February 1, 2000, with termination to take place April 30, 2001.
  3. OPTION TO EXTEND THE TERM OF THIS LEASE: Lessor shall present Lessee a new -----  
rent to extend this lease for a five-year period under the same terms and conditions as this current lease on or before June 15, 2000. Lessee shall have the option to extend this lease at the new rate under the same terms and conditions. Lessee must exercise this option in writing delivered to Lessor on or before 5:00 P.M. on August 1, 2000 or Lessee loses all rights to extend this lease and Lessor may begin work to replace the windows and entrance to the building as described in paragraph 12 any time after August 1, 2000. If Lessee exercises this option, the term of the five-year extension shall commence on May 1, 2001.
  4. RENT: The annual rent to be paid to Lessor by Lessee shall be computed at -----  
the rate of \$13.50 per square foot, or an annual rental of \$130,788, payable in monthly installments of \$10,899.00, in advance on the first (1st) day of each month commencing February 1, 2000. Said payment shall be made to The Hillsborough Group at P. O. Box 4190, Manchester, New Hampshire 03108-4190.
- LATE PENALTY: All rents due on the first shall be received by Lessor on or before the tenth (10/th/) of each month. Lessor will impose a Late Penalty of one and one-half percent (1.5%) per month, each month on the balance owed and not received by the fifth or twentieth of each month.
5. SECURITY DEPOSIT: A security deposit consisting of an amount equal to one -----  
(1) month's rent shall be paid commensurate with the payment of the first monthly rental payment. Said security deposit will be held by Lessor and may, in no event, be used as rent by Lessee and will be returned to Lessee at the end of the term subject to all terms and conditions of this lease are met;

6. COST OF OPERATION: The parties agree that each shall furnish and pay for

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the cost of operation as indicated below:

To be furnished by:

- |  |        |
|--|--------|
| a. Heat as required -  | Lessee |
| b. Electricity as required -   | Lessee |
| c. Replacement of bulbs and fluorescent tubes -  | Lessee |
| d. Water and sewerage charges -  | Lessee |
| e. Replacement of broken glass -   | Lessee |
| f. Janitor, window washing and cleaning services -   | Lessee |
| g. All maintenance and repairs to the demised premises under the control of Lessee -   | Lessee |
| h. Common area costs, including clearing and removal of ice and snow from walkways and parking lot area; sanding; utility room; trash removal, and grounds maintenance - | Lessee |
| i. Real estate taxes -   | Lessee |
| j. Insurance (as described in paragraph 7) -   | Lessee |
| k. Structural integrity of the roof and replacement of any part of the HVAC system when necessary -  | Lessor |

7. REAL ESTATE TAXES AND INSURANCE: Lessor will maintain all-risk property

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insurance on said property in the amount of the lesser of: 1.) at least fair market value of said property, or 2.) replacement value of said property. Lessor will also maintain combined bodily injury and property damage insurance on said property in an amount of at least Five Hundred Thousand Dollars (\$500,000.00). Such insurance shall be issued by financially responsible insurers duly authorized to do business in the State of New Hampshire.

Lessor may obtain additional coverage provided that any increases in coverage will be reasonably related to the fair market value of the premises.

Payments for insurance premiums and real estate taxes will be due and payable within twenty (20) days after statement for same have been received by Lessor and have been presented to Lessee. Lessor will provide Lessee with a certificate or proof of such insurance and real estate costs.

Lessee will be responsible for obtaining and maintaining its own liability insurance on its own business and operation within said property, as well as insurance coverage on its own personal property and equipment, said insurance shall be in an amount of not less than Five Hundred Thousand Dollars (\$500,000.00) per incident and One Million Dollars (\$1,000,000.00) in aggregate.

8. LESSOR'S OBLIGATIONS: In addition to any of the obligations of Lessor

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contained herein, Lessor shall:

a. Maintain and repair the roof, including the removal of snow if deemed to exceed structural capacity of building, and all structural portions of the premises and of the building of which the premises are a part; and

b. Maintain and repair of fuel storage tank(s).

9. LESSOR'S REMEDIES: Lessor may deem Lessee to be in breach of this lease

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following any of the following events:

a. That Lessee should fail to pay rent or other charges and assessments when due and payable under this lease within ten (10) days following written notice of such default therein;

b. That Lessee shall fail to commence curing any other violation of its covenants within twenty (20) days after written notice thereof or, having commenced to cure same as aforesaid, shall fail to carry same to conclusion with due diligence; and

c. Upon the adjudication of Lessee as a bankrupt or the appointment of a receiver of its property.

10. UNTENANTABILITY: If the premises, or any portion thereof, are made

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untenantable by fire, the elements, or other casualty, rent for the leased premises, or affected portion thereof, shall abate from date of such casualty to restoration of tenantability. Lessor shall restore same with all reasonable speed and, if Lessor does not restore the premises, or the affected portion thereof, to tenantability within one hundred twenty (120) days thereafter, Lessee may then terminate this lease. If the premises are more than fifty percent (50%) destroyed by such casualty, either Lessor or Lessee may terminate this lease unless Lessor is able to rebuild and restore the premises within one hundred twenty (120) days of such casualty. Rent shall abate during such period of untenantability.

11. INSPECTION: Lessor shall have the right upon reasonable notice to enter

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the premises during normal business hours for reasonable inspections and, in addition, shall have the right to show same to prospective tenants during the last two hundred forty (240) days of the term.

12. IMPROVEMENTS TO THE REAL ESTATE: Lessor shall have the right to re-

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landscape and make cosmetic changes to the exterior of the building during the term of the lease. Lessor shall also have the right to replace the windows and entrance to the building and place a for lease sign on the property if the Lessee does not exercise the option to extend this lease (paragraph 3). This work will be coordinated with the Lessee so that the business operation of the Lessee will not be disturbed and security of the facility is not compromised.

13. SIGNS: Lessor must approve, in advance of installation, any signs, letters

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and/or plaques which Lessee desires to affix to the building, doors, windows, or any part of the premises. Such approval shall not be unreasonably withheld.

14. LESSEE'S ALTERATIONS AND IMPROVEMENTS: Lessee shall not make any

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alterations or improvements to the demised premises without the prior written consent of the landlord, which consent shall not be unreasonably withheld.

15. LESSEE'S IMPROVEMENTS: Upon the termination of this lease, or any

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extension thereof, any and all improvements, alterations or modifications which are affixed to the real estate, and normally considered to be part of the real estate, shall become the property of the Lessor. This includes, but is not limited to, ceilings, flooring, carpeting, shelving (which is affixed to the real estate), partitions, walls, wall coverings and the like. At the termination of this lease, Lessee may remove its own personal property not considered part of the real estate, such as Venetian blinds, curtains, office equipment, business machines, trade fixtures, signs and the like, not affixed to the real estate.

16. CONDEMNATION: If the leased premises, or any significant portion thereof,  
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are taken by eminent domain, or condemned for public use, this lease may be terminated by either the Lessor or Lessee, and any and all awards for such taking shall be the exclusive property of the Lessor; provided, however, that nothing contained herein shall be construed to preclude Lessee from prosecuting any claim directly against the condemning authority in such condemnation proceedings for loss of business or depreciation or, damage to, or cost of removal of, or the value of stock and other personal property belonging to the Lessee; provided, however, that no such claim shall diminish or otherwise adversely affect Lessor's award or the award of any mortgagee.

17. LEGAL FEES: In the event that Lessor is obligated to maintain legal action  
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against Lessee for the collection of rent or other charges or assessments under this lease, or for any other matter in connection with said lease, or as a result of Lessee's default and providing that Lessor prevails, then Lessor will be entitled to receive reimbursement for attorney's reasonable fees and costs incidental to such legal action.

18. SUCCESSORS AND ASSIGNS: This lease is binding on the parties hereto and  
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their respective heirs, executors, administrators, successors and assigns. This lease may be assigned by Lessee, to its parent, subsidiary, or sister corporations, provided Lessee shall remain obligated to make all payments required hereunder.

19. ENTIRE AGREEMENT: This lease embodies the entire agreement between the  
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parties. There are no promises, terms, conditions or obligations referring to the subject matter, other than those contained herein. There may be no modification of this lease except in writing, executed by both Lessor and Lessee, with the same formalities as this lease.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be signed by a duly authorized officer and the corporate seal affixed hereto on the day and year first above written.

LESSOR:  
  
THE HILLSBOROUGH GROUP

/s/ Constance Fournier  
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Witness

By: /s/ Harold Butler Jr.  
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Its: Partner

LESSEE:  
  
PC CONNECTION, INC.

/s/ R.A. Pratt  
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Witness

By: /s/ Wayne L. Wilson  
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Its: President



CORPORATE ORGANIZTIONAL STRUCTURE:

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PC Connection, Inc., a Delaware corporation, is the parent company of the following wholly-owned subsidiaries:

1. PC Connection Sales Corporation, a Delaware company.
  - o PC Connection Sales of Massachusetts, Inc., a Delaware company (subsidiary of PC Connection Sales Corporation).
2. Merrimack Services Corporation, a Delaware company.
3. Comteq Federal, Inc., a Maryland company.
  - o Comteq Federal of New Hampshire, a Delaware company (subsidiary of Comteq Federal, Inc.).

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in the Registration Statements Nos. 333-40172, 333-69981, 333-50847, 333-50845, and 333-83943 of PC Connection, Inc. on Form S-8 of our report dated January 25, 2001, appearing in the Annual Report on Form 10-K of PC Connection, Inc. for the year ended December 31, 2000.

DELOITTE & TOUCHE LLP

Boston, Massachusetts  
March 27, 2001